United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

ORIGINAL WITH PROOF OF SERVICE

75-7031

75-7038 75-7055 75-7057

To be argued by
SIDNEY B. SILVERMAN

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

B
P/S

HOWARD BERSCH,

Plaintiff-Appellee,

v.

DREXEL FIRESTONE, INCORPORATED, DREXEL HARRIMAN RIPLEY, BANQUE ROTHSCHILD, HILL SAMUEL & COMPANY, LIMITED, GUINNESS MAHON & CO., LIMITED, PIERSON, HELDING & PIERSON, SMITH BARNEY & CO., INCORPORATED, J. H. CRANG & CO., and INVESTORS OVERSEAS BANK, LIMITED,

Defendants,

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,

Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF THE PLAINTIFF-APPELLEE

SILVERMAN & HARNES
75 Rockefeller Plaza
New York, New York 10019
Attorneys for Plaintiff-Appellee

(4580)

COUNSEL PRESS, INC., 55 West 42nd Street, New York, N.Y. 10036 • PE 6-8460

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Defendants-Appellants

Appeal from the United States District Court for the
Southern District of New York

BRIEF OF THE PLAINTIFF-APPELLEE

INTRODUCTION

Defendants' statements of the issues, facts and description of the action as contained in their briefs are in large part inaccurate, incomplete and unresponsive to the

issues raised in the certified appeal.* A point-by-point refutation of defendants' distortions would, plaintiff believes, serve only to distract from the genuine issues involved in this interlocutory appeal. However, certain errors which permeate the defendants' briefs must be corrected now in order to dispel a false and prejudicial atmosphere which these errors may have created. Accordingly, plaintiff sets forth such rectification below:

1. Defendants' contention: Plaintiff purchased his stock on September 3, 1969, prior to the public offering of the common stock of I.O.S., Ltd. (Public Offering).

   The Facts: Plaintiff purchased his stock on September 24, 1969 at the Public Offering. On September 3, 1969. plaintiff subscribed for I.O.S., Ltd. (IOS)stock to be

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* Defendants appear obsessed with the question of class action determination, an issue decided in June, 1972, by the Honorable Marvin E. Frankel, and devote a large portion of their briefs to such issue, although it is not before this Court on this appeal. Indeed, in two preliminary rulings, the first denying defendant Arthur Andersen & Co.'s (Andersen) motion to consolidate this interlocutory appeal with another appeal from an interlocutory order, and the second disallowing leave to defendant Andersen to file an outsized brief of 120 pages, the excess pages being devoted to "an earnest presentation of an issue of tremendous importance and far-reaching consequences, namely, whether Rule 23 is invalid," this Court made plain that it did not wish to hear the class action issue raised by defendants.

purchased at the Public Offering. The subscription form completed by him stated that his order would not be accepted until 21 days after the close of that offering. (47 A-2)*. Plaintiff's confirmation reflects that his purchase was made on September 24 as part of the Public Offering. (47 A-2).

2. Defendants' contention: Plaintiff illegally "bootlegged" stock, thereby deceiving an IOS employee who accepted plaintiff's subscription.

The Facts: Plaintiff did not practice deception upon defendants in connection with his purchase of IOS stock at the Public Offering. The subscription agreement and confirmation clearly reflected plaintiff's U. S. residence. Further, the delay in delivering a stock certificate to plaintiff was explained in a printed form letter as caused by "the fact of your U. S. citizenship [which] occasioned time-consuming formalities with the Internal Revenue Service in order to reduce your tax liability." (47 A-3). Not only

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* "PA" refers to plaintiff's appendix; "A" refers to the appendix submitted by defendantsappellants Andersen, IOS and Cornfeld. Two appendices have been submitted on this appeal. Plaintiff desired a joint appendix and was willing to pay for the documents which he wished included therein. Defendants, having first suggested a joint appendix, subsequently refused to print the documents designated by plaintiff.

did plaintiff have no personal basis for believing the sale to him to be illegal, but the very same printed form letter advised him to complete enclosed tax forms in order to have "the option of selling your shares to other U.S. citizens." The form letter was not signed by a clerk, but rather a member of IOS legal department (47 A-5).

2. Defendants' contention: Only eleven American residents purchased IOS stock.

The Facts: There were at least 46 Americans residing in the United States who purchased IOS stock at the IOS Public Offering. Three lists of United States citizens purchasing IOS stock and the addresses of such purchasers were furnished to the Securities and Exchange Commission by IOS. Those lists indicate that 386 Americans purchased 1,507,578 shares of IOS stock and that the 46 Americans resident in the United States purchased 51,548 shares (227 A-228 A, 229 A - 232 A, 131 PA - 160 PA). Thus, Americans purchased over 13.7% of the total shares sold at the Public Offering. It is likely that offers to purchase were made to many other Americans resident here, and abroad.

Prior to the production of the aforesaid list, plaintiff stated that to his knowledge, at least eleven Americans resident in this country had purchased IOS stock and that other American residents here sold IOS stock in the secondary. (73A-74A).

4. Defendants' contention: The class is composed of 100,000 persons.

The Facts: In the complaint, plaintiff alleged that there were 100,000 potential class members based on his estimate that the average class member purchased 100 shares. However, discovery has revealed that the average American purchaser purchased 3906 shares. Based upon an average purchase of 4,000 shares by Americans and information furnished by defendants with whom settlement has been reached and who have addressed envelopes to class members in order to mail the notice of settlement, plaintiff now estimates that the class has approximately 25,000 members.

5. Defendants' contention: A proceeding instituted in Switzerland against defendant Bernard Cornfeld (Cornfeld) and other IOS directors will provide all plaintiffs an adequate vehicle to recover their damages.

The Facts: The criminal action pending in Switzerland is not a fair alternative to the instant action, as recognized by one of the attorneys representing the complainants therein who sought to have his clients included in the present action. He stated in a letter to plaintiff's counsel, dated April 11, 1974, as follows:

> "In recollection of our meeting in September 1973 with Mr. Hafner, the class action suit you brought before the New York District Court concerning the 1969 issuing of IOS Ltd shares was discussed.

> As I told you I am representing many clients who bought IOS Ltd shares in September 1969. I would appreciate you telling me what is the current legal situation.
>
> Please let me know if you are also in a position to represent my clients in this action. I would be glad to send you more information if you need it." (234 PA).

Such persons have not been intervened in reliance upon Judge Frankel's class action order.

THE ISSUE PRESENTED FOR REVIEW

Did the District Court correctly decide that it had subject matter jurisdiction to determine the claims of persons who purchased IOS stock at the Public Offering as against defendents Andersen, Cornfeld and IOS.

STATEMENT OF THE CASE

1. Identification of the Parties

A. Plaintiff and The Class

Plaintiff is a United States citizen and a resident of New York.(72-A). On September 24, 1969, the date of the IOS Public Offering, he purchased 600 shares of the IOS common stock. Plaintiff's nationality and residence were plainly disclosed on his confirmation of purchase dated September 24, 1969 and on the order to purchase submitted by him on September 3, 1969 (47 A-1, 47 A-2).

The prospectuses disseminated in the Public Offering were read by plaintiff in the United States (73-A). Plaintiff paid for his IOS stock in New York with a check drawn on a New York bank and his certificates were subsequently mailed to him in New York (72-A). Defendant IOS informed plaintiff and other U.S. purchasers by a printed form letter that delivery of certificates to U.S. citizens had been delayed pending resolution of United States tax matters. Plaintiff was advised to fill out enclosed forms for exemption from the interest equalization tax* in order to enable him to resell his stock to other U.S. citizens. (47 A-3, 47 A-8).

The record discloses that in addition to plaintiff, some 386 other Americans purchased an aggregate of 1,507,578 shares of IOS stock. Thus, total purchases by Americans constituted approximately 13.7% of the total number of shares sold. 46 Americans residing in the United States purchased 51,548 shares of stock. The remaining shareholders, approximately 25,000 foreign residents, purchased the balance of 11,000,000 shares offered to the public. All purchasers at the Public Offering, foreign and American, comprise the class.

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* Defendants' contention that unfavorable tax treatment would discourage United States purchasers appears, in view of plaintiff's experience, to have had no basis in fact.

B. Defendants

(i) Andersen

Defendant Andersen is an accounting firm headquartered in this country. It has acted as the accounting firm for defendant IOS and its affiliated organizations, both abroad and in this country. Andersen prepared the financial statements and other data which portrayed IOS as a thriving, growing concern whose financial affairs were in order and being prudently managed. While some of defendant Andersen's routine accounting work was done in this country, the bulk of such work was probably done abroad. However, a critical ten-hour meeting was held with Andersen and other principals in the Public Offering in September 1969, in order to review errors in Andersen's work which reflected adversely upon IOS's financial condition, and to determine whether, in light of the aforementioned disclosure, the public offerng should commence. (223 A-1, 223 A-6). As a result of such meeting, the decision was made to complete the offering, notwithstanding the obvious defects in Andersen's work and the revelation of IOS' true financial posture.

(ii) Cornfeld

Defendant Cornfeld, the founder of IOS, was its President and Chairman of the Board, and acted as the Chief Executive Officer of the Company. (42-PA). He is

a United States citizen, presently living here (175-181 PA). At the time of the Public Offering, defendant Cornfeld resided in Geneva, Switzerland. Defendant Cornfeld sold 820,448 shares of IOS to the public for which he received $7,794,256 (189-A, 184-A).

Several weeks prior to the Public Offering, defendant Cornfeld touted IOS in two United States news weeklies. In the NEWSWEEK article (208 A - 106 - 208 A - 109), Cornfeld expansively promoted his enterprise:

> " On his brassy past record, Bernie wastes little time worrying about who does, and does not, think him proper. Sheer size has a way of enhancing anyone's reputation. Not to mention his clout. And come September, IOS will be a lot bigger. It plans then to more than double its current net assets ($66 million) by selling a fifth of its stock, to European and Canadian investors, for an expected $100 million. What will he do with all the money?
>
> Bernie has dozens of ideas. He personally last week made a $1 million bid for a tract of land near the IOS computer center at Nyon in Switzerland. He intends to build a university. For IOS, Bernie is thinking of buying big jets to fly customers to the vacation centers that his real-estate subsidiaries are building in Spain, the Bahamas and Florida. He also talks of launching a worldwide credit-card system, a travel agency, a communications empire featuring film studios and television stations. And then, of course, Bernie still sees vast opportunities in mutual funds.
>
> 'Worldwide People's Capitalism is our goal,' Bernie says evenly. 'And when you see what we have done in ten years, there is no reason to believe the goal utopian.'" (208 A-109).

The other defendants were aware that Cornfeld's public utterances made just prior to the Public Offering were illegal and they tried unsuccessfully to prevent publication of defendant Cornfeld's statements. Having failed to prevent publication, they, nevertheless, permitted the Public Offering to go forward. (Deposition of Bertram D. Coleman taken April 3, 1973, p. 134).

(iii) Defendant IOS

Defendant IOS is a Canadian corporation. Its principal offices, at the time of the Public Offering, were located in Geneva, Switzerland. At that time, defendant IOS' principal business activity was the management of mutual funds which invested primarily in United States securities. In addition, defendant IOS was a sponsor of a large condominium development in Florida (50-PA, 103-PA, 107-PA), maintained an office on Madison Avenue in New York (73-PA) and was closely affiliated with the New York brokerage firm of Arthur Lipper Corp. Arthur Lipper Corp., 1970-71 CCH Fed. Sec. L. Rep. ¶78,126 (SEC 1971). Defendant IOS was controlled and managed by U.S. citizens and was popularly identified as a U.S. company (169-PA).

(iv) J. H. Crang & Co. (Crang)

Defendant Crang, at the time of the Public Offering, was a Canadian-based broker-dealer registered with the U.S. Securities and Exchange Commission (SEC). Defendant Crang managed a secondary distribution of 1,450,000 shares of IOS stock in Canada.

(v) Defendants Drexel Firestone, Inc., Smith Barney & Co., Incorporated, Banque Rothschild, Hill, Samuel & Co., Limited, Guinness Mahon & Co., Limited, and Pierson, Heldring & Pierson. (Drexel Group)

The above defendants were the managers of a primary offering of 5.6 million shares of IOS stock. Defendant Drexel Firestone, Inc. (Drexel) was the managing underwriter. Defendant Drexel maintained principal offices for the conduct of its business in both Philadelphia and New York. Defendant Smith Barney & Co. (Smith Barney) maintained its principal executive offices in New York City. The remaining underwriters are located abroad. These defendants have entered into a settlement with plaintiff, pursuant to which they have agreed to pay $700,000 to the class and to pay

for administering the mailing and publication of a notice to the class of the pendency of this class action and the settlement. *

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* Defendants have, in the proceedings in the Court below and in prior arguments before this Court, attacked the settlement as being too low in relation to the damages claimed and have suggested that it was reached solely to provide a basis for plaintiff's counsel to obtain fees. However, the settlement was reached only after discovery revealed a sufficient basis for plaintiff to evaluate the "due diligence" defense which was available only to the settling defendants and after the plaintiff had received letter assurances from the attorneys for these defendants, Messrs. Davis Polk & Wardwell and Sullivan and Cromwell, that statistical data of trading by class members revealed that more than one-half of the class were able to resell IOS stock at the Public Offering price or in an amount in excess thereof. In addition, the Supreme Court's decision in Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974), decided after commencement of this action, which determined that plaintiff must bear the cost of giving personal notice, would have imposed upon plaintiff a burden of approximately $50,000 to give the required notice. Such a burden was clearly beyond plaintiff's means and the Settling Defendants' agreement to bear that burden made it possible for this action to proceed against the remaining defendants whom plaintiff believes to be the principal wrongdoers in the action.

2. Prior Proceedings

This action was commenced as a class action in December, 1971, on behalf of all persons who purchased IOS stock at the IOS Public Offering. (5A-19A). The complaint alleged that the prospectus pursuant to which the IOS Public Offering had been made was false and misleading in that it failed to reveal material facts concerning IOS' finances, illegal activities, chaotic bookkeeping, mismanagement and actual looting and plundering of IOS' treasury. Plaintiff and the class paid $110 million for their purchase of IOS stock. Within six months of the Public Offering, that stock was worthless. Plaintiff contends that if all material facts had been disclosed, the class would have known that the stock had no value and would not have purchased it.

In 1972, plaintiff moved for class action determination. On June 28, 1972, the Honorable Marvin E. Frankel ruled that "[t]he action may be maintained as a class action on behalf of all purchasers of IOS shares in the 'IOS Public Offering' as detailed in the complaint, of 10,992,000 shares beginning in 1969." (84-A). The Court deferred a final determination of the applicability of the American securities laws until after discovery. However, it held that plaintiff had, at the time of the motion, adduced enough factual allegations to allow the case to proceed as a class action.

Following the granting of class action status, plaintiff embarked upon an extensive course of discovery on the question of jurisdiction. The parties signed a stipulation limiting such discovery to the following areas, which the parties deemed relevant to the issue of jurisdiction:

1. The significance of the fact that two lead underwriters were American firms.

2. The making of key decisions in the United States.

3. The significance of the fact that American accountants were employed.

4. Whether American selling shereholders were "heavily involved" in the "arguably" integrated group of offerings.

5. The extent of sales to Americans in the United States.

6. The extent to which legal "decision" and "actions" regarding the prospectuses were made by American law firms.

7. Whether IOS although a foreign corporation, was "American in its management and in its impact both abroad and here."

8. Whether the offerings had an effect upon the American securities market and the American economy. (86-A).

After the discovery outlined above had been completed, defendants moved before the Honorable Robert L. Carter to dismiss the action and, alternatively, to modify or amend Judge Frankel's class action order. (94-A, 107-A, 110-A, 150-A, 159-A, 192-A-1). In an opinion dated November 26, 1974, Judge Carter denied defendants' motions to dismiss, except for defendant Crang's motion to dismiss for lack of personal jurisdiction and reserved decision on defendants' motion to modify Judge Frankel's class action order.

Judge Carter certified the question of subject matter jurisdiction raised by the defendants and on January 7, 1975, this Court granted defendants Andersen, Cornfeld and IOS' motion for leave to appeal on the question of subject matter jurisdiction. The appeal was expedited with oral argument set for March 6, 1975.

On December 4, 1974, Judge Carter implemented the stipulation of settlement reached with the Drexel Group, directing that notice be given to the class of the proposed settlement, and of class members' rights under Rule 23(c) (December 4 Order). Defendant Andersen moved on December 19, 1974, before this Court to stay the December 4 Order pending decision on Andersen's application for leave to appeal. Immediately following the argument on December 20, 1974, this Court granted the requested stay

On December 26, 1974, defendant Andersen appealed from the December 4 Order, contending that such Order represented a determination sub silentio of defendant Andersen's motion to modify Judge Frankel's class action order. On January 14, 1975, defendant Andersen moved to consolidate its appeal from the December 4 Order with the appeal granted on the certified question. This Court, by order dated January 29, 1975, denied consolidation.

On January 31, 1975, defendant Andersen moved for leave to file a brief of not less than 120 printed pages. In its application, defendant Andersen stated that it intended in its brief to make "an earnest presentation of an issue of tremendous importance and far-reaching consequences, namely, whether Rule 23 is invalid." The Court denied defendant Andersen's motion for leave to file a brief of 120 pages.*

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* In the brief of 75 pages, which was filed one day late, the Constitutional issue was omitted, defendants nevertheless, attempted to restate the class action issues in terms of jurisdiction, and, thus, to have them heard at this time.

3. Jurisdictional Conduct Within the United States as Found By Judge Carter

Judge Carter, in his careful, well-reasoned opinion, found that the defendants performed many significant acts within this jurisdiction. Each such finding was supported by documentary evidence produced by defendants or testimony adduced at depositions. The acts found by Judge Carter appear at 263 A - 267 A. A synopsis of his findings with the appropriate record support follows:

1. Representatives of IOS, major underwriters, their attorneys and accountants met in New York on numerous occasions in order to initiate, organize and structure the Public Offering.

Judge Carter based his findings on Documents Nos. 1 and 2 (192 A-119, 193 A). * In addition, other documents such as 1, 2, 6, 18, 23, 31, 54, 67(a), 67(b) (192 A-119, 193 A, 193 A1-3, 208 A-24-208 A-26, 95 PA, 96 PA-98PA, 119 PA-120 PA, 121 PA) support this finding.

2. A New York law firm was retained here and held meetings with IOS' representatives in New York to discuss the listing of the shares, tax problems and the location of the Offering.

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* In an appendix, plaintiff submitted evidence which substantiated the jurisdictional acts. Reference to "document numbers" refers to material contained in the appendix submitted to the Court below.

Judge Carter based his findings on Document No. 6 (193 A-1)(264 A). Other documents supporting the finding are found in 65 PA - 69 PA.

3. Drexel officials and its counsel met with the SEC to discuss the Public Offering and regulatory problems which the SEC was having with IOS. At these meetings and by letter, defendants were informed that sales to United States citizens, even abroad, would violate an Order prohibiting IOS from selling securities to Americans and would require the entire offering to be registered.* In addition, defendants were informed that even if no sales were made to Americans, the anti-fraud provisions of the Federal Securities Laws would apply.

Judge Carter based this finding on Documents Nos. 8 and 44 (96 A, 214 A). In addition, documents Nos. 10 and 41 support this finding. (73 PA, 213 A-3).

4. Price Waterhouse was retained in New York to assist in analyzing and reviewing the operations of IOS as part of the defendants' due diligence functions. Many meetings with Price Waterhouse took place in New York and at those meetings representatives of the underwriters, accountants and attorneys were present.

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* Defendants repeatedly cite and quote a SEC release which exempted foreign offerings from the registration requirements of the Securities Act. While that ruling does reflect a relaxation of some regulation where only foreign purchases are concerned, it nowise reflects an inapplicability of the anti-fraud provisions of the Exchange Act.

Judge Carter based this finding on Documents Nos 11, 13, 15-20, and 23. (195 A-1, 195 A-4, 196 A, 208 A-1, 208 A-5, 208 A-16, 208 A-20, 208 A-24, 208 A-27, 208 A-28, 208 A-41). In addition, other parts of the record reflect that at a ten-hour meeting in New York City Price Waterhouse reviewed for the defendants the deficiencies in defendant Andersen's financial report of IOS' affairs and thereby put all participants in the offering on notice of many of the charges subsequently brought by plaintiff. See Document Nos. 45 - 47 (215 A - 223 A-6). Typical questions raised by Price Waterhouse at the aforesaid meeting in New York included the following:

> "8. Has AA [Arthur Andersen] considered whether transactions with the Arthur Lipper Corporation and other possibly affiliated parties have been adequately disclosed or other audit procedures or scope changed in light of the disclosure on August 15, 1969 that I.O.S. had guaranteed as of December 31, 1968 a one million dollar loan made to A. Michael Lipper by Guiness [sic] Mahon? Does AA audit Guiness Mahon and/or Arthur Lipper Corporation?
>
> * * *
>
> 15. What is the contingent liability significance of I.L.I.'s* losing the basic records of 651 insured lives and about $80,000 of annual premiums? Are reserves adequate to cover these "lost" lives, should there be no premiums received henceforth against future death claims?
>
> 16. Is AA satisfied that GRT (Group reducing term) commission are properly recorded? Has AA considered directly circularizing officers and directors of companies in the I.O.S. family about loans and advances

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* International Life Insurance Company, an IOS subsidiary.

to such persons received from the I.O.S. companies rather than indicating audit disclosure limitations imposed by Swiss bank secrecy laws? Should the change in methods in providing actuarial reserves and the amounts be disclosed in the financial statements? Should special reserves be disclosed separately? Should lapsed liquidation proceeds be held as a liability longer than desire before being reflected in income.

* * *

27. Is the borrowing of Mr. Cornfeld from ODB* (through Butler Aviation having discounted a $150,000 note receivable from Mr. Cornfeld) included in the amounts that were due from officers, directors and employees? Did this transaction have implications as to other similar or related loans and, if so, were they disclosed?

* * *

32. Was the reporting by I.O.S. of the dividend receivable by shareholders of record on December 31, 1968 on I.O.S. Management Company stock reasonable in view of the fact that I.O.S. recorded the stock as having been sold before December 31, 1968?

* * *

36. Is there enough time left to carry out all the work necessary before public offering or should there be some delay?"

5. At meetings held in New York during the months of July and August, 1969, the price and underwriting discounts and commissions were agreed upon. All pertinent financial information on IOS and the mutual funds advised by it was delivered to Price Waterhouse in New York and kept on file there. Drafts of opinion letters to be issued by counsel were prepared and reviewed in New York and defendant Andersen conducted

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* Overseas Development Bank, an IOS subsidiary.

its review of the records of mutual funds managed by IOS, which records were regularly maintained in New York.

Judge Carter based this finding on Documents Nos. 22-42 (208 A-30 - 213 A-4).

6. Pertinent parts of the prospectus were drafted in New York and read over the telephone to persons in Geneva. Many letters concerning the offering emanated from New York and a closing memorandum was printed in New York and distributed from there to all participants.

Judge Carter based this finding on Documents Nos. 50, 52 (223 A-7 - 223 A-30).

7. Throughout the pre-offering period, syndication operations and other means and methods of distributing the IOS stock were discussed in New York. Defendant Crang met in New York with an IOS officer in an effort to obtain a large share of the offering for his firm. (Documents Nos. 4, 27, 73). (62 -64 PA, 208 A-66-69, 119 PA). Other prospective American underwriters were solicited and those without a European office were shown a draft of the prospectus in New York. Doc. No. 43 (81 PA). All syndication operations were coordinated in New York and share allotments for the various underwriters and dealers were made in New York. Doc. Nos 36, 37, 39, 40, 42, 49, 51 (208 A-112 -208 A-114, 213 A-1 - 213 A-2,213 A-4, 86-89PA, 90-93PA).

Judge Carter based this conclusion upon Documents Nos. 4, 27, 36, 37, 39, 40, 42, 43, 49, 51, 73.

8. As the Public Offering date drew near, preparations in New York intensified. A memorandum setting forth the procedure to be followed in connection with the Public Offering was prepared and distributed in New York (236-239 A). Bank accounts were opened at the Bank of New York and instructions given to underwriters and dealers that payments for the shares should be made to that Bank in United States dollars.

Judge Carter based this finding on Document No. 51. (90 PA - 93 PA).

Judge Carter correctly summed up the above activities as follows:

> "Obviously, many of the documented occurrences, taken by themselves, are of minimal significance. Nonetheless, these circumstances viewed in toto disclose conduct constituting an essential link in the offering in the United States. While formal or ultimate acts were staged in Europe -- e.g., the drafting of the final prospectus and signing of agreements -- discussions, investigations, decision-making and planning were carried on, to a significant extent in the United States by Americans and others, and the acts abroad were substantially supervised from New York. Instrumentalities of interstate commerce were commonly used. Much of the effort that went into the due diligence report and preparation of the material basic to all the prospectuses also appears to have been expended in the United States." (267 A).

In addition to the substantial acts upon which Judge Carter specifically based his opinion, the record provides evidence of many additional acts occurring in New York. These acts will be set forth in Point I below.

4. The Integrated Offering

Judge Carter correctly found that the Public Offering, although tripartate in structure, was actually integrated.* He based this finding in part upon an analysis of the purpose of the primary and secondary offerings, recognizing that one would not have occurred without the other. The primary and secondary features of the offering were necessary concomitants. Without a new issue to provide funds for the issuer, reputable underwriters would not participate in the offering. Without a secondary which allows management to realize on their investment, there would have been no incentive for the primary offering. The two were separated only because United States underwriters were involved. In general, responsible underwriters will not permit management to "bail out" without providing financing for the issuer. However, since it was the intention of the defendants to sell IOS stock to United States nationals, since American underwriters could not be involved in such sales, and since IOS was prohibited from selling its securities to Americans, an artificial separation was structured. Sales to Americans

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* The defendants dispute Judge Carter's finding that the three offerings were part of any integrated whole, contending that "integrated offerings" occur only when a so-called private sale is followed by the Public Offering. However, the fact that the term "integrated offerings" has been used in a particular circumstance does not mean that such characterization is exclusive nor preclude its use in a different context.

and "friends" were delegated to IOB, an IOS subsidiary, having little or no assets. Thus, behind the facade of separation, the secondary offerings managed by defendants Crang and IOS provided a vehicle by which the controlling shareholders of IOS were able to dispose of 5,400,000 shares at an aggregate price of $54,000,000, while the primary offering provided financing for IOS.

Judge Carter found that deposition testimony and documents reflected that the offerings were made simultaneously and at the same price. Further, the prospectuses used were in all material respects, identical.

The parties themselves recognized that the Public Offering involved the integration of the three different parts:

> "1. Defendant Crang, in an inter-office memo dated August 29, 1969, stated:
>
> 'The offering of common shares of I.O.S., Ltd. to the public will total approximately $120,000,000 which will represent 20% of the total number of shares outstanding of the company. This new issue will be offered in Canada, the United Kingdom, Europe and other countries. The portion that will be offered in Canada (all Provinces) for Canadian distribution only, will approximate $15,000,000. J. H. Crang & Co. will be managing underwriter and will form a group of 10 to 12 of the leading investment firms in Canada to distribute this portion. The Canadian, United Kingdom and European offerings will be coordinated to be offered on or about September 24th. The issue price which will not be set until 3 or 4 days before the official offering date, will be between $10 and $11 per share which, incidentally, works out to be approximately 15 times current earnings."(161-162 PA).

2. In a telex to Cowett, Howe referred to the 'Canadian participation' and agreed to have the Canadian banking group assembled at the same time as the U.K. and European underwriters. (163 PA).

3. In a letter dated May 13, 1969, from Howe to Cowett, the former says:

'When we last met in New York to discuss the forthcoming issue of I.O.S., Ltd.(S.A.) I indicated to you that we would like to distribute $10,000,000 of the anticipated $96,000,000. You suggested $8,000,000. I would appreciate it if you could raise the Canadian participation to the $10,000,000. Any chance?'

* * *

'To borrow a Gil Smith phrase, will this underwriting require a coordinating underwriter or will S.A. coordinate? Obviously there will have to be one underwriting agreement between S.A. and the managing underwriters, and a uniform banking group agreement between them and their banking groups.' (119 PA).

4. After the offering was concluded, I.O.S. stock was listed on the Toronto and Montreal Exchanges. Drexel Harriman was invited to attend the listing ceremonies. A telex revealed that firm's reply: "I quote Drexel Harriman via Grayson Murphy.'Love to help but ---'". (164 PA).

5. Murphy also treated the offering as a unitary one. In a letter to the SEC, dated May 14, 1969, he said:

'We are acting as counsel for Drexel Harriman Ripley, Incorporated ('DHR') in connection with the proposed public offering outside the United States of approximately $90,000,000 of common stock of I.O.S. Ltd. (S.A.) ('I.O.S.'), of which about half is expected to be newly issued shares and about half a secondary offering.

> It is proposed that DHR, the London merchant banking firm of Guinness Mahon & Co., Ltd. and a French bank to be selected will be the three managing underwriters of a syndicate composed mostly of foreign firms that would underwrite about two-thirds of the $90,000,000 of stock. The remaining one-third would be offered by I.O.S. to certain of its employees and to some of the non-United States holders of shares of mutual funds that I.O.S. manages." (194 A).

The SEC also considered the Public Offering to be an integrated one. In a letter to the attorney for the Drexel Group, leader of the primary offering, the SEC commented as follows on the intention to sell stock to IOS employees in the secondary offering: "We would like to point out, however, that any sale of IOS' stock to its employees who are nationals of the United States but residents abroad would be subject to the registration requirements of the Securities Act of 1933." (213 A-3). The Drexel Group's attorney did not state that the secondary offering was separate and apart from the primary and, accordingly, exempt. Rather, he informed the SEC that care would be taken to prevent the purchase by Americans in any of the offerings.

In a second letter, the SEC referred to "the part of the offering managed by Investors Overseas Bank" and stated that sales to U.S. nationals would violate "the Commission's order of May 25, 1967." (214 A). In view of the many sales and, undoubtedly, many offers of sale made to U.S. nationals

and the integrated nature of the over-all transaction, the Public Offering was required to be registered under the Securities Act.

5. The American Character of The Public Offering

The Public Offering was American in concept and execution. It was, at the time, the second largest equity offering ever made. The principal participants in the Public Offering were properly identified as Americans. IOS was controlled by Americans and its image was that of an American Company. It engaged in the business of managing mutual funds which invested in U.S. Securities, had many U.S. sub-investment advisers and also conducted a real estate enterprise in Florida. Bertram Coleman, Chairman of the Board of Drexel, confirmed the predominate role of Americans in IOS:

> "A. I think it was generally public information that IOS had a certain number of American sub-advisers."
>
> * * *
>
> "A. I would say IOS' entire business was managed by Americans. Cornfeld and Cowett were both Americans. If that's what you mean.
>
> Q. Was the fact that Cowett and Cornfeld were Americans, in your opinion generally well known?
>
> A. Yes, I think it was." (169 PA).

Defendants Drexel and Smith Barney, principal underwriters, are United States corporations registered with the SEC. Defendant Crang was also registered with the SEC. Defendant Andersen is also American. American law firms participated in the preparation of the prospectuses. Americans constituted a large proportion of the sellers in the secondary offering. Plaintiff Bersch is an American and purchased his stock in America. Many other Americans purchased at the Public Offering.

Professor Morris Mendelson of the Wharton School confirmed that foreign investors regarded the Public Offering as an American undertaking:

> "Although IOS was a Canadian corporation with its principal place of business in Geneva, it was owned and managed by Americans engaged principally in the activity of selling and managing mutual funds which, in turn, invested in United States securities. IOS is identified as an American company in the mind of investors. The underwriters, led by an American firm and assisted by American accountants, enhanced the image in the public mind that this offering was an American Type offering. American attorneys participated in the preparation of the prospectus. The subsequent failure of the Public Offering of an American type company, led by an American team, reflected poorly upon the financial services of this country and served to undermine investor confidence in America and abroad in United States securities." (71 A-5)

POINT I

THE DISTRICT COURT HAS SUBJECT MATTER JURISDICTION

It is now well established that the American securities laws have extraterritorial reach. Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972); Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) en banc, cert. denied sub nom. Manley v. Schoenbaum, 395 U.S. 906 (1969). The "presumption of territoriality" of regulatory law to which defendant Andersen has recourse has been greatly qualified since 1949,* and the concept of strict territoriality has been replaced by a more sophisticated jurisdictional calculus. This has developed as a result of the expansion of international commerce and the increasing internationalization of securities transactions. Although the scope of the securities laws' application has not been precisely defined, in determining their extraterritorial effect, certain basic principles have been adopted and applied by the courts to the facts of each particular case. The jurisdictional issue presented upon this appeal involves

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* Defendant Andersen relies strongly upon Foley Bros. v. Filardo, 336 U.S. 281, which was decided in 1949.

two distinct, yet interrelated considerations:

1. Does the United States District Court have the power under international principles of law to assert jurisdiction over the subject matter of this action.

2. Assuming power to adjudicate under international rules, does statutory intent impose any limits upon the transnational reach of the securities laws* as based upon the facts of this case.

Each question will be separately dealt with below.

A. The District Court Has Subject Matter Jurisdiction Under Established Principles of International Law

Courts traditionally have been concerned with their power to exercise subject matter jurisdiction in international disputes. In such cases, the rules of international law

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* As the court below noted, its jurisdiction "emanates primarily from §27 of the Securities Exchange Act of 1934, 15 U.S.C. §78aa" (Exchange Act) and plaintiff refers primarily to that section in his brief. However, as the court further found:

> "To the extent that some of plaintiff's claims arise under the Securities Act of 1933, its jurisdictional provision—Section 22, 15 U.S.C. §77v—should be viewed as being coextensive in reach with that of the 1934 Act. This conclusion is dictated by the language of each statute as well as by the statutes' shared function in policing securities transactions that are effected within the United States or that have a significant domestic impact. (260A).

define the competence of a country to assert jurisdiction over the challenged transaction. In the instant case, plaintiff submits that jurisdiction can be established under accepted principles of international law. This conclusion is based primarily upon territoriality, the cardinal jurisdictional principle in international controversies. That principle holds that a state has the power to exercise control over conduct within its territory or conduct without which produces effects within. Both facets of the doctrine are applicable herein.

1. Significant Conduct in Furtherance of the Fraud Occurred Within the United States: The Subjective Territorial Principle

A state has traditionally had jurisdiction over unlawful acts or omissions which occur within its boundaries, even though the effects of such acts or omissions are felt without. §17 of the RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (1965) sets forth this basic principle as follows:

> "A state has jurisdiction to prescribe a rule of law
>
> (a) attaching legal consequences to conduct that occurs within its territory whether or not such consequences are determined by the effects of the conduct outside the territory; and

(b) relating to a thing located, or a status or other interest localized, in its territory."

The subjective territorial principle has had a significant development in modern times with respect to the jurisdiction of a state to prosecute and punish criminal behavior.* As a result of the continued growth of industrial society and the global expansion of business, jurisdiction in criminal cases has been enlarged in order to protect the public interest and regulatory legislation, both penal and remedial in nature, has been increasingly accorded extra-territorial effect. See, for example, United States v. Weisscredit Banca Commerciale E. D'Investimenti, 325 F.Supp. 1384 (S.D.N.Y. 1971).

The courts have adopted the subjective territorial principle as enunciated in the RESTATEMENT in cases involving the extraterritorial reach of various United States statutes and, in particular, have applied the American securities laws extraterritorially where significant conduct relating to the transaction over which jurisdiction is sought occurred in the United States. The challenged transaction in this case, the fraudulent public offering of securities, involves many separate but interrelated actions, which took place in various international locations. However, subject matter jurisdiction will be

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* Research in International Law, 29 Am. J. Int'l. L., 435.

established if necessary and substantial acts within the United States can be shown.

In Leasco v. Maxwell, supra, the court applied §17 of the RESTATEMENT, holding that "significant conduct within the territory" is sufficient to confer subject matter jurisdiction.* In that case, an American company sought damages allegedly resulting from the purchase of shares of a British company on the London Stock Exchange. Meetings held and misrepresentations made in the United States were found sufficient to justify the application of §10b of the Securities Exchange Act, since the alleged conduct within the United States was "an essential link" in the transactions.

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* Judge Friendly stated with respect to §17 of the RESTATEMENT:

> "While the black letter seems to require that, in a case like this, not only there should be conduct within the territory but also the conduct relate 'to a thing located, or a status or other interest localized, in its territory.' Comment A and illustrations 1 and 2, * * * appear to be satisfied if there has been conduct within the territory. Conduct within the territory alone would seem sufficient from the standpoint of jurisdiction to prescribe a rule. * * * (Emphasis included). 468 F.2d at 1334.

In Leasco the court stated by way of dictum that it saw no reason why, for the purposes of jurisdiction, "making telephone calls and sending mail to the United States should not be deemed to constitute conduct within it." This view* was adopted by the court in Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973), where subject matter jurisdiction was founded upon letters and telephone conversations between the United States and Canada, even though the securities involved were "foreign

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* See also, Arthur Lipper Corp. 1970-71 CCH Fed. Sec. L. Rep. ¶78,126 (SEC 1971) where the Commission stated at p. 80,439:

> "Respondents also assail the jurisdiction of the Commission, arguing that the Exchange Act does not have extra-territorial application with respect to the obligations owed by IOS to the IOS related funds, and that since IOS and the IOS funds were foreign corporations, their respective rights must be determined by application of appropriate foreign law, the provisions of which are not shown on the record. That argument is unconvincing in light of the fact that not only were the United States mails used to place Cowett's scheme in motion, but the very securities transactions that were required if the scheme were to bear fruit were effected on the United States over-the-counter markets. Where a scheme is one which is necessarily accomplished by use of the mails or interstate facilities within the United States, it seems clear that the remedial protections of the Exchange Act are properly invoked in the interests of maintaining and assuring the integrity of this nation's securities markets."

ones that had not been purchased on an American exchange." 473 F.2d at 524. The court stated:

> "In our view, subject matter jurisdiction attaches whenever there has been significant conduct with respect to the alleged violations in the United States." 473 F.2d at 524.

In Roth v. Fund of Funds, Ltd., 405 F.2d 421 (2d Cir. 1968), aff'g 279 F.Supp. 935 (S.D.N.Y. 1968), cert. denied 394 U.S. 975 (1969), a 16(b) case involving a Canadian mutual fund, Fund of Funds, Ltd. (FOF), based in Switzerland and investing in United States securities, the Exchange Act was held applicable since the challenged transactions were effected on a domestic exchange. In addition, FOF had placed its purchase and sale orders by telephone to New York and had arranged for payment through the New York correspondent of FOF's Swiss Bank.

a. Significant Acts Occurred Here.

In the instant case, significant conduct with respect to the fraudulent offering occurred within the United States so as to establish jurisdiction over the subject matter of this action. Discovery in this case has disclosed that conduct in the United States was involved continually throughout the entire period during which the IOS Public Offering was conceived, assembled and effected and that such conduct was an integral part of the overall scheme. Examples of such conduct, culled from discovery, are set forth below, in the main chronologically:

1. March 12, 1969 - in New York. Henry Buhl of IOS and "Martin" of Guinness Mahon Representation Co. of 115 Broadway, New York, had a meeting with Paul Miller of Drexel at its New York office to discuss the proposed IOS Public Offering. (192 A-119).

2. March 27, 1969 (A)* - in New York. Henry Buhl and "Martin" had a second meeting with Drexel in New York. The two meetings "prepared the ground quite satisfactorily for Drexel Harriman Ripley to get acquainted with the IOS organization." (193 A)

3. March-April (A)* - in New York. Browning and Sonne of Drexel went to Geneva from New York. The decision to send them was made by Coleman and Berry after a discussion with the Drexel Executive Committee. (59 PA - 61 PA)

4. End of April - in New York. Howe of Crang met with Cowett of IOS in New York at the offices of Arthur Lipper, IOS's brokerage arm in New York. The meeting continued the following day at the Carlyle Hotel. At the meeting, the two principals discussed the Canadian participation in the IOS Public Offering:

> "We discussed at that time the general concept of the underwriting, because we thought it was a very exciting company. I urged him to give consideration to Crang & Company doing a Canadian underwriting. As I recall, I even tried to get the whole underwriting.
>
> And I recall Cowett saying, well, of course, we weren't big enough, and we were strictly Canadian, and this would be a world-wide underwriting.
>
> To my knowledge, that is pretty well all that took place at that meeting. The main thing was that we urged him to allow us to take a portion of the underwriting and do a Canadian underwriting." (62-63 PA).

5. May, 1969 - in New York. Shearman & Sterling was retained in New York by Drexel in connection with the IOS Offering. Murphy, of that firm, discussed the matter with his partners "as fully as seemed necessary" before agreeing to undertake the representation. (65 - 69 PA).

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* (A) - approximate

6. May 13, 1969 - in New York. Murphy had a conference with Browning and Sonne and a telephone conversation with Browning. Murphy met with Cowett; Browning and Sonne were present. The meeting had been arranged by Drexel. They discussed where the shares in the public offering were to be listed, and the tax problems of IOS' top executives. In addition, Murphy had several telephone conferences with Cowett. Murphy did not recall the substance of his conversations, but obviously they had to do with the IOS public offering. (193A-1-3).

7. May 13, 1969 - in New York. Murphy called Hamer Budge, Chairman of the SEC, to arrange a meeting with the Commission concerning possible financing for IOS. On the next day, Murphy put his request in writing. The letter was delivered by hand to the SEC. (194-195A)

8. May 14, 1969 - in Washington. Murphy and Browning and Sonne of Drexel met with SEC personnel in Washington. Thereafter, at a Drexel Executive Committee meeting and board meeting, two memoranda pertaining to the meeting with the SEC were discussed. Pertinent parts from those memoranda are excerpted below:

> "We feel that we owe it to I.O.S. this week to advance to some extent, and in some direction, our decision of whether we will manage their proposed first public offering in Europe. The purpose of this memorandum is to bring you up-to-date on the events which have occurred since the Executive Committee meeting on Wednesday, May 14 at where the I.O.S. financing was first discussed." (197A)
>
> * * *
>
> "Mr. Freedman said that the Commission was concerned that the necessary information concerning I.O.S. for a prospectus might not be obtained by us and pointed out that the Commission had had past difficulties in getting information from I.O.S. He mentioned that that was the lesson of the Bar-Chris case although, he added, 'I guess I shouldn't say that.'" (199A)
>
> * * *
>
> "Alan Mostoff said, 'We know more than you do but we don't want to tell you', but immediately added that that was not what he meant to say. * * * He said that he understood this was a big financing and that we were 'big boys'

and if we wanted to do business with I.O.S. to go ahead (implying that we would take whatever attendant risks there were)." (200 A)

* * *

"Substantively the S.E.C. was concerned not only about fund shares being sold to Americans in Europe without Securities Act registration but also over a number of management practices considered illegal or overreaching by U.S. standards. Some of those are discussed briefly below.

A. The Fund of Funds ('FOF') prospectus compared the fund's performance with various U.S. stock averages without disclosing that the comparison assumed reinvestment of dividends for FOF but not for the stock averages.

B. A number of the I.O.S. funds pay an annual management fee of 1% which would be unacceptable in the United States. The fee is disclosed.

C. FOF pays I.O.S. 75% of the acquisition charge for distributing FOF and a management fee of 1/2% but I.O.S. gets the following typical compensations:

(i) I.O.S. invests FOF in sub-funds owned and managed by I.O.S. I.O.S. gets a brokerage commission of 1% for placing these investments. (I.O.S. is considering ending this practice.)

(ii) For 'managing' the sub-funds I.O.S. gets a management fee of 10% of appreciation. This fee is split with independent managers hired by I.O.S. to actually manage the sub-funds.

(iii) I.O.S. arranges loans of securities for FOF for a slight fee.

(iv) Only dollars are invested in FOF. When investors send in other currencies, which represent only a small portion of total investments, I.O.S. purchases dollars for them and retains a standard profit on currency exchange.

(iv) FOF features a contractual plan under which life insurance completes the program if the investor dies. I.O.S. underwrites the insurance at an attractive premium.

D. Since voting and other corporate controls of funds are in the hands of I.O.S., the fund management fees can be revised by I.O.S. at any time without vote or approval of fund shareholders." (207-208A)

9. May 15, 1969 - in New York. Murphy had a conference with Robert J. Haft, Esq. (Haft), New York counsel for IOS. Murphy wanted to find out about difficulties of IOS with the SEC. He was informed by Haft that the SEC claimed violations of the Securities Act and the Investment Company Act with respect to the sale of unregistered securities and the keeping of records. In addition, Murphy made an independent investigation in New York concerning the aforesaid violation. (70-72 PA)

10. May 27, 1969 - in Washington. Greene of the SEC called Murphy and turned down the requested meeting. He stated that a letter would follow with the reasons therefor. On June 6, 1969, that conversation was confirmed by letter. Because of the significance of that letter, it is quoted in full below:

"Dear Mr. Murphy:

The Commission has considered your letter of May 14, 1969 and does not believe that any useful purpose would be served by your meeting with the Commission to discuss the business plans of your client, Drexel Harriman Ripley, Incorporated, a registered broker-dealer, in so far as they relate to I.O.S., Ltd. (S.A.). The Commission has, however, authorized me to advise you of the following which may be of assistance to you.

As a general rule, a registered broker-dealer may participate in the underwriting outside of the United States of a security not registered under the Securities Act of 1933 of a foreign issuer and which is to be offered and sold to foreign nationals only (Securities Act Release No. 4708, July 9, 1964;

Investment Company Act Release No. 5618, February 25, 1969). However, through Securities Act registration of such an offering is not required, the anti-fraud provisions of the Securities Act and the Securities Exchange Act of 1934 would, in general, be applicable to the activities of a registered broker-dealer participating in such an underwriting.

The Commission has noted your statement of your client's intent 'to make a thorough study of I.O.S. and its subsidiaries and to prepare a prospectus which would be consistent with SEC requirements'. In this connection, you may be interested in the fact that I.O.S., in its relationships with the Commission, has on several occasions taken the position that, because of the secrecy laws of Switzerland, where its principal business activities are assertedly located, it was unable to furnish the Commission with certain requested information. The enclosed copies of the Commission's order for public proceedings In the Matter of I.O.S., Ltd. (S.A.), dated February 3, 1966, and the Commission's order approving the settlement of such proceedings dated May 23, 1967, may be helpful to you." (73 PA).

11. June, 1969 - in New York. Berry, on behalf of Drexel, retained the services of Price Waterhouse as a consultant in connection with the IOS Public Offering. (195A-1-3).

12. June, 1969 (A) - in New York. Smith Barney's Commitment Committee held a meeting in New York and discussed the IOS Public Offering. The Committee decided that Smith Barney should participate and authorized commitment of the firm's capital to the project. (74-76 PA).

13. June 6, 1969 - in New York. Werblow of Price Waterhouse reviewed certain material in connection with Price Waterhouse's investigation. Several days later Werblow held a meeting with Browning and indicated Price Waterhouse's agreement to undertake the assignment as consultant. (195A-4-5).

14. June 11, 1969 - in Philadelphia. The Executive Committee of Drexel held a meeting. Murphy rendered an oral report on the meeting with the SEC, and Browning also participated in the discussions. (77-78PA).

15. June 16, 1969 - in New York and Philadelphia. A meeting of the Drexel Board of Directors was held in New York and Philadelphia connected by telephonic intercommunication. The Browning and Sonne memorandum was distributed to the Board. The sole purpose of the meeting was to discuss the IOS offering. A decision was made to go forward with further investigation. Coleman was given authority to conclude an agreement to undertake the operation if he thought it appropriate. (208A-1-4).

16. June 17, 1969 - in New York. Haft wrote Joyce of Shearman & Sterling with respect to IOS - Revenue Properties Company, Limited, and its difficulties with the SEC in connection with the alleged illegal sale of unregistered shares. (208A-6-15).

17. June 17, 1969 (?) - in New York. Stoddart of Price Waterhouse made a trip to Florida in order to inspect IOS' real estate project there.(208A-20-23).

18. June 24, 1969 - in New York. A meeting was held, attended by Sonne and Ambrose of Drexel, Murphy and Nangle of Shearman & Sterling, representatives of Arthur Andersen, and Werblow of Price Waterhouse. A report on the meeting was given to Coleman. "There was a discussion as to what procedures Price Waterhouse might be able to advise Drexel to ask IOS to require the Andersen firm to perform in a post-audit review which Andersen would conduct to give us further assurance on the June 30th figures." Based upon the meeting, it was decided to put together a team to go to Geneva with representatives of Drexel, Shearman & Sterling and Price Waterhouse. (208A-24-26).

19. June 25, 1969 - in New York. Grace of Smith Barney's Corporate Finance Department sent a telex to Vesel and Bischof of Smith Barney, reporting on a June 23 meeting giving the consensus of opinion in the United States on competing for lead underwriter. (208A-27).

20. Summer, 1969 - in New York. McDonough of Price Waterhouse visited Arthur Andersen's offices in New York.

He wanted to look at the work papers of Arthur Andersen to find out more about the mutual funds and had been advised that the working papers were in New York. He was accompanied on this visit by Erera, another member of Price Waterhouse. Werblow discussed Erera's visit to Arthur Andersen in New York on the telephone from London or Geneva with Maynard, a third Price Waterhouse member, in New York.(208A-28-29).

21. Summer, 1969 - in New York. Howe of Crang discussed the IOS underwriting with Arthur Lipper. He asked Lipper what he thought about IOS Limited and the people involved. (79-80 PA).

22. July 2, 1969 - in New York. Haft sent Joyce of Shearman & Sterling a copy of a proposed letter to Hamer Budge, Chairman of the SEC, requesting a hearing with regard to threatened injunctive action against the IOS group. He advised Joyce that Haft and Cornfeld would meet with the Commission's staff. He asked Joyce to advise Drexel of this information.(208A-31-40).

23. July 3, 1969 - in New York. A conference was held by Price Waterhouse personnel (Werblow, VonGlahn, Stoddart, Biegler, Burge and McDonough), Murphy and Joyce of Shearman & Sterling, Browning, Ambrose, Sonne, of Drexel and Lechner, Treasurer of IOS. At the meeting, the timetable of the offering was discussed as was the contemplated work of Arthur Andersen. The functions of Arthur Lipper with relation to the IOS mutual funds were described. IOS' activities in the United States were discussed and Lechner revealed the Florida apartment project which was discussed further. Lechner indicated that mutual funds managed by IOS invested in United States securities.(208A-41-47).

24. July 7, 1969 - in New York. The Haft memorandum was circulated to Drexel executives working on IOS. (208A-48-58).

25. July 7, 1969 - in New York. A conference was held with Werblow, Murphy and Nangle attending.(208A-59).

26. Early July, 1969 - in New York. A meeting was held between Cowett and Coleman. Coleman advised Cowett that Drexel wanted to enter into a "firm or reasonably firm agreement." They discussed possible terms of the offering, mostly to do with prices. They may have discussed underwriting discounts, commissions to be paid members of the selling group. They discussed the Crang offering. An understanding was reached with Cowett that

all three portions of the offering would be at the same price. Coleman testified that this meeting was in furtherance of Drexel's Board's directive. Coleman discussed his meeting with Cowett and with Drexel personnel going to Geneva with Murphy. (208A-60-65).

27. July, 1969 - in New York. Howe had a meeting with Cowett. Crang was then in the process of preparing a draft prospectus and Howe and Cowett discussed the IOS secondary offering. (208A-66-69).

28. July 8, 1969 - in New York. A meeting was held in New York attended by Werblow, VonGlahn, Browning, Ambrose, Joyce and Lechner. The purpose of the meeting was to arrange to get additional information from Lechner, specifically of a financial nature. Financial statements of IOS companies were requested. Within ten days, the information on various mutual funds was received from IOS, mailed and addressed to Werblow in New York. The material received was copied in part and distributed to certain staff members of Price Waterhouse working on the project. The originals of the material copied were returned to Geneva. (208A-70-78).

29. July 8, 1969 - in New York. A meeting was held by Berry, Murphy, Ambrose, Browning and Werblow. Berry was filled in on the previous meeting, which he had not attended. (208A-79-81).

30. July 11, 1969 - in New York. A meeting was held by Werblow, VonGlahn, Murphy, Joyce, Tiffert, Ruegger and Duncan of Arthur Andersen, Browning, Ambrose, Sonne and Leary of IOS. Discussion was held as to the time required to get out the 1968 financial statements of IOS. A time-table with respect to a possible audit by Arthur Andersen was discussed. Leary discussed IOS' desire to have an offering in September and the reasons why IOS was eager that it be launched at an early date. (208A-82-94).

31. July 11, 1969 - in New York. A meeting was held in New York by Coleman, Ambrose, Murphy and Werblow. The meeting was called to advise Coleman as to what had happened at the meeting with the IOS people and the representatives of Arthur Andersen. At the meeting, they discussed what Drexel wanted to explore with IOS in connection with Arthur Andersen's work on the June financials. (208A-95-98).

32. July 13, 1969 - in New York. Werblow met at Drexel with Tiffert of Arthur Andersen and VonGlahn. They discussed the specifics of what Andersen would do in connection with the June 30, 1969 financials. Arthur Andersen counted the amount of work it would do, pointing out the large number of companies involved. It stated that the overall project was a complex undertaking. (208A-99-100).

33. July 25, 1969 - in New York. Murphy had a telephone conversation with Joyce in Geneva and Feder of Willkie, Farr & Gallagher. In New York he had a conference with Alan Conwill of Willkie, Farr & Gallagher, counsel for Crang. (208A-101-105).

34. July 28, 1969 - in New York. An article appeared in Newsweek touting IOS stock and quoting defendant Cornfeld. (208A-106-109).

35. July 30, 1969 - in New York. Coleman reported on the status of the IOS underwriting to the Drexel Executive Committee. (208A-110-111).

36. After July - in New York or Philadelphia. Knowlton of Smith, Barney met with Coleman at the Drexel office to discuss the IOS offering. (208A-112-113).

37. August 6, 1969 - in New York. Vesel cabled Knowlton concerning the invi ation of Smith, Barney by IOS into the selling group of the forthcoming issue. (208A-114-116).

38. August 7, 1969 - in New York. Murphy wrote to the SEC in order to obtain an opinion from the SEC that the IOS public offering is exempt from registration requirements of the Securities Act. (209A-213A).

39. August 13, 1969 - in New York. Ruddick of Smith Barney telephoned Bischof abroad as to personnel who would attend a Paris meeting as Smith Barney's representative. (213 A-1)

40. August 13, 1969 - Bischof cabled from Paris to Knowlton in New York that Dresdner Bank of Germany had declined the IOS co-managership. (213A-2).

41. August 21, 1969 - John Heneghan of the SEC informed Murphy by letter that every sale of IOS stock to its employees who are nationals of the United States but reside abroad are subject to the registration requirements of the Securities Act of 1933.(213 A-3)

42. August 29, 1969 (A) - Bischof, abroad, cabled Knowlton in New York discussing a meeting with Coleman with respect to the underwriting, selling participation and "accounting matters". As a result of the cable, Knowlton objected to Smith Barney's participation percentage, probably calling Cowett in Geneva directly. (213 A-4)

43. August to early September, 1969 - in New York. American firms and prospective underwriters were shown preliminary prospectuses. "Those prospectuses were taken around by hand. They were brought from Europe by hand and they were taken around by hand by Mr. Cluett to talk to the people and one of the people I know was Goldman Sachs." (81-83 PA)

44. September 8, 1969 - in Washington. A letter was sent from Heneghan to Murphy in New York. The letter is quoted in full below:

"Dear Mr. Murphy:

This is with further reference to your letter of August 7, 1969, regarding the proposed public offering in Europe by an underwriting syndicate headed by Drexel Harriman Ripley, Incorporated, of shares of I.O.S., Ltd. as well as two additional offerings of the shares of I.O.S., Ltd.

In addition to the matter referred to in our letter of August 21, we would also like to point out that in connection with the part of the offering managed by Investors Overseas Bank, if any of the 'larger holders of shares of investment companies managed by the company or its subsidiaries,' or any of the 'other persons having business relationships with the company or its subsidiaries,' are United States citizens or nationals, the prohibitions of the Commissions' order of May 23, 1967 would be applicable to any offer or sale to such holders or persons." (214 A)

45. September 10, 1969 - in New York. Field, Maynard, and Werblow of Price Waterhouse met with Coleman, Ambrose and Murphy. They discussed the preliminary draft of a report by Price Waterhouse. The substance of the meeting was "what the words were going to be in the report." The report was drafted by Maynard, Roth, Field and Werblow. The report was revised at the meeting in part and more revisions were made afterwards. Price Waterhouse in its reports uncovered many of the illegal practices engaged in by IOS and alerted the defendants, in New York, that the prospectus was false and misleading. Typical were the following comments:

> "As a general question, and without being specific as to individual points, did AA take into account in their audit procedures for 1968 the effect of weaknesses discussed in their internal accounting control memorandums recently issued on I.O.S. and on the mutual funds that IOS manages?"
>
> "Has AA considered whether IOS has a significant contingent liability to the mutual funds it manages or their shareholders for not processing on a timely basis orders around audit dates, and/or for processing orders throught the year at possibly incorrect prices? Does AA check fund prices at selected dates, throughout the year?"
>
> "Has AA considered whether transactions with the Arthur Lipper Corporation and other possibly affiliated parties have been adequately disclosed or other audit procedures or scope changed in light of the disclosure on August 15, 1969 that IOS had guaranteed as of December 31, 1968 a one million dollar loan made to A. Michael Lipper by Guiness [sic] Mahon? Does AA audit Guiness Mahon and/or Arthur Lipper Corporation?"
>
> "Has AA satisfied itself that full and fair disclosure has been made in the financial statements as to transactions with G.S. Herbert & Co., a London broker, or the London and Dominion Trust Company both located in the same premises as the Arthur Lipper London offices? Does AA audit G.S. Herbert & Co. or London and Dominion Trust Company? Are securities transactions effected at "arms length" prices?"
>
> "Is AA satisfied that GRT (Group reducing term) commission [sic] are properly recorded? Has AA considered directly circularizing officers and directors of companies in the IOS family about loans

and advances to such persons received from the IOS companies rather than indicating audit disclosure limitations imposed by Swiss bank secrecy laws? Should the change in methods in providiing actuarial reserves and the amounts be disclosed in the financial statements? Should special reserves be disclosed separately? Should lapsed liquidation proceeds be held as a liability longer than desire[sic] before being reflected in income."

"Was AA able to account for the location and ownership of all share certificates of subsidiaries in the 'army of companies' included in the IOS group, as referred to in the AA internal control memorandum? Were intracompany relationships fully disclosed as appropriate in the circumstances?

"Is the borrowing of Mr. Cornfeld from ODB (through Butler Aviation having discounted a $150,000 note receivable from Mr. Cornfeld) included in the amounts that were due from officers, directors and employees? Did this transaction have implications as to other similar or related loans and if so, were they disclosed?"

"Are the relationships and transactions with Ampersand on an arms length basis? Who audits Ampersand?

"Was the reporting by IOS of the dividend receivable by shareholders of record on December 31, 1968 on IOS Management Company stock reasonable in view of the fact that IOS recorded the stock as having been sold before December 31, 1968?"

"How does AA consider the reasonableness of carrying values used in a natural resources fund? Does AA audit King Resources?"

"Has AA considered the pertinence of consolidating the 100% owned Fund of Funds Proprietary Fund with the accounts of the Fund of Funds and if so, the effect this would have on the 1% expense limitation set forth in the prospectus of the Fund of Funds?" (215A-223A).

46. September 11, 1969 - Boston. Paine Webber informed Hill Samuel in London by letter that it did not wish to participate in the IOS financing. The letter indicates that Paine Webber had been solicited by telephone to join the offering. (84 PA).

47. September 12, 1969 - in New York. Field, Maynard Roth, Werblow, Coleman, Ambrose and Murphy held a meeting to discuss another draft of the Price Waterhouse report to Drexel. They also discussed a summary of the matters Price Waterhouse had discussed with Arthur Andersen in order to prepare a report for Arthur Andersen. They expressed a desire to prepare a report giving Price Waterhouse's views which would be meaningful to Drexel. (223A-1-6).

48. Late September, 1969 - in New York. Murphy communicated with Charles Young printers by telephone and arranged for the printing in New York of IOS closing memorandum. (85 PA).

49. September 21, 1969 - in New York. A message was sent to Bischof that all final IOS share allocations will be made through the New York office. This message stated "any commitments contrary to this procedure will be reported to H. Knowlton." (86 PA).

50. September 23, 1969 - in New York. Coleman and Murphy and Stammer of Stammer & Haft, held a meeting and discussed a sticker to the prospectus. The language of the sticker was formulated in New York and transmitted to Geneva probably by telephone. The press had announced a contemplated SEC action involving Investors Planning Corp. Murphy stated that the participants in the meeting wanted to find out "everying we could about this matter and that was the purpose of the meeting". Murphy made several telephone calls to Geneva that evening to talk about the SEC action and to try and work out what should be said in the prospectus sticker. The decision as to the sticker was a joint decision of Murphy and Coleman in New York and Conwill in Geneva. (223A-7-18).

51. September 25, 1969 - A letter was sent from Smith Barney to the United Overseas Bank, S.A., directing it to make payment for the IOS shares to Chemical Bank New York Trust Company, 20 Pine Street, New York, New York . (90 PA).

52. September 29, 1969 - in New York. Murphy sent out 14 letters distributing the IOS closing memorandum. (223A-19-32)

53. September 11, 1969 - Banque de Bruxelles informed Kenney of Smith Barney in New York of its decision not to underwrite the IOS issue. (94 PA).

54. Early October, 1969 - in New York. A meeting was held by Werblow, Ambrose and Browning to discuss Price Waterhouse's fee. (95 PA).

55. October 13, 1969 - in New York. Knowlton had lunch with Buhl and Arthur Lipper. (96-98 PA).

56. October 14, 1969 - in New York. A telegram was sent by Drexel stating "please note that payment is due today in New York." (223A-33).

57. October 14, 1969 - in New York. Instructions were given by Drexel that payment for the purchase of shares in the IOS offering was to be in United States dollars to the Bank of New York, 8th Floor, 20 Broad Street, New York, New York 10015. The instructions stated that this was the only way that payment could be made. (223A-31).

58. September 10, 1969 - in New York. The Drexel Executive Committee passed a resolution establishing bank accounts with the Bank of New York in New York in connection with the IOS offering. (223A-35-38).

59. August 16 (A) - in New York. A telegram from Bischof in Geneva to Rudick in New York states that Bischof will attend the Paris manager's meeting and return to New York to discuss corporate questions involved. (99 PA)

60. September 16, 1969 - in New York. Richard Robinson, the President of Keyes-Penn Mortgage Company, in Florida, sent Browning of Drexel his conclusions with respect to the Hallendale project. (103-107 PA).

61. September 15, 1969 - in New York. Robinson wrote Browning that in addition to the Hallendale development, IOS has another project in Florida, called La Mer. (100-102 PA).

62. August 20, 1969 - in New York. Boyer reported that a U.S. company, Bankers Bond and Mortgage Co. has prepared an extensive report on IOS's Hallendale project.(108 PA).

63. Status reports on the progress of the IOS Public Offering were periodically made to the Drexel board.(223A-41-42).

64. Written reports on Price Waterhouse's progress were circulated in New York.(See, for example, 224-225A).

65. Price Waterhouse's staff, assigned to the IOS Public Offering, performed substantial services in New York, as evidenced by time sheets. (109-117 PA).

66. United States facilities for international travel were utilized.(See, for example, 118 PA).

67. Meetings were held with IOS management on numerous occasions throughout the period in which the Prospectus was being prepared. (119-123 PA).

68. United States citizens, namely, Cornfeld, Cowett and Lechner, officially approved the offering and the prospectus "as accurate and complete." Cowett made additional specific representations as to the truth of the prospectus and acted on behalf of all the selling stockholders. (178A, 187A, 190A, 124-125 PA).

69. Despite contrary representations made to the SEC, sales were made to Americans, living at home and abroad. Names and addresses of such persons are listed in three communications from the law firm of Willkie, Farr and Gallagher to the SEC. (226-228A; 228A-1232A; 131-160PA).

70. The procedure by means of which the IOS Public Offering would be made was determined in New York. A memorandum describing such procedure was prepared and distributed in New York. (236-239A).

It is clear from the examples above that conduct constituting an "essential link" in the challenged transaction took place in the United States. The Public Offering was discussed, approved, initiated, organized and consummated in the United States by the major underwriters, their attorneys and accounting consultant. Underwriting capital was committed here. Meetings were held here with leaders of the major foreign participants, including Howe of Crang and Cowett of IOS. Due diligence meetings were held in the United States and the evidence of IOS' true condition was presented here. The work done abroad was supervised from the United States as Coleman and Murphy shuttled back and forth between Europe and New York, the former reporting their progress to the Drexel board. An amendment to the prospectus was written here, as was the closing memorandum. Copies of the prospectus were circulated by hand to the offices of various New York brokerage firms and were read by the plaintiff here. Legal decisions and actions by American law firms affecting the terms and handling of the prospectus were made here. The plaintiff and other Americans made their purchases of IOS shares here. Americans, residing here and abroad, offered their shares

for sale and received the proceeds from the sale thereof. The facilities of interstate commerce were used abundantly. Discovery has revealed that innumerable telephone calls, telegrams, letters, and intercontinental flights were utilized in effecting the challenged transaction. Payment for the shares purchased was made here.

Importantly, conferences were held here with the SEC staff and the defendants were informed here that in the opinion of the Commission, the anti-fraud provisions of the American securities laws applied to the IOS Public Offering. Thus, the defendants can claim no unfair surprise by the application of American law.*

The court below detailed in its opinion the extensive conduct which formed the primary basis for its decision. (263A-267A). It considered many of the documented occurrences "of minimal significance" by themselves, but found that such occurrences "viewed in toto disclose conduct constituting an essential link in the offering in the United States."

The court further held that the "significant conduct within the territory" requirement of Leasco was

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* Avoidance of "surprise" is one of the goals of international law.

not limited to the making of false representations within the United States. That holding of Judge Carter is supported by basic principles of law governing continued and joint activities relating to fraud.* In Steele v. Bulova Watch Co., 344 U.S. 280 (1952), in determining subject matter jurisdiction, the Supreme Court found immaterial the fact that the major portion of the violation charged had been committed in Mexico and that acts in the United States, "when viewed in isolation", did not violate any of our laws. The court stated that "acts in themselves legal lose that character when they become part of an unlawful scheme." p. 287. The holding in Steele has been followed by the courts on numerous occasions. Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690 (1962); Brunswick Corp. v. Vineberg, 370 F.2d 605 (5th Cir. 1967); Jerrold Electronics Corp. v. Westcoast Broadcasting Co., 341 F.2d 657 (9th Cir. 1965) cert denied 382 U.S. 817 (1965). Thus, when performed in concert, lawful acts may become unlawful. United States v. United States Gypsum, 333 U.S. 364 (1948). Indeed, the court remarked in Schulman v. Burlington Industries, Inc., 255 F.Supp. 847, 852 (S.D.N.Y. 1966), a private antitrust suit, "unlawful conspiracies commonly consist in part of conduct entirely lawful in itself ...

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* Under the common law, fraud was considered a "transitory tort", and an action would properly lie in any court of general jurisdiction which had personal jurisdiction over the defendant. Corpus Juris Secundum , Fraud §§ 74, 75.

But these steps may serve as 'part of the sum of acts which are relied upon to effectuate the conspiracy***' American Tobacco v. United States, 328 U.S. 781, 809, 66 S. Ct. 1125, 1139, 90 L.Ed. 1575 (1946)."

In Continental Ore, the Supreme Court held:

> "In cases such as this, plaintiffs should be given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each. '* * * [T]he character and effect of a conspiracy are not to be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole. United States v. Patten, 226 U.S. 525, 544, 33 S.Ct. 141, 57 L.Ed. 333 * * *; and in a case like the one before us, the duty of the jury was to look at the whole picture and not merely at the individual figures in it.' American Tobacco Co. v. United States, 147 F.2d 93, 106 (C.A. 6th Cir.). See Montague & Co. v. Lowry, 193 U.S. 48, 45-46, 24 S.Ct. 307, 309, 48 L.Ed. 608."
>
> 370 U.S. at 699.

Analogies may be drawn to the criminal law. 18 U.S.C. §3237 (a), the "continuing offense statute", states:

> "Except as otherwise expressly provided by enactment of Congress, any offense against the United States begun in one district and completed in another, or committed in more than one district, may be inquired of and prosecuted in any district in which such offense was begun, continued, or completed.

> Any offense involving the use of the mails, or transportation in interstate or foreign commerce, is a continuing offense, and, except as otherwise expressly provided by enactment of Congress, may be inquired of and prosecuted in any district from, through, or into which such commerce or mail matter moves."

Although this section refers to venue, the principle behind its enactment is directly applicable to the issue of jurisdiction.

The complaint herein charged that the defendants committed and conspired to commit acts which constituted violations of the full disclosure and antifraud provisions of the National Securities Laws and that the Participating Underwriters "aided and abetted the defendants IOS and Cornfeld in their scheme to defraud the class." (17A). Accordingly, under the doctrine of Steele, significant acts in the United States in furtherance of that scheme, even if otherwise lawful, would be deemed sufficient to warrant the exercise of jurisdiction.

Additionally, illegal acts other than the alleged misrepresentations occurred here. The "gun jumping" and "market priming" activities alleged in paragraph 18(b) occurred within the United States. A ten hour review of

Price Waterhouse's critique of defendant Andersen's work* took place in New York. This review identified all of the weaknesses existing in the IOS organization. With knowledge that the condition of IOS was as bad as Price Waterhouse had discovered, defendants, nevertheless, determined to go forward with the offering despite conclusive evidence that the company was not a proper one for investment by the public. Thus, the actual underwriting, itself, was a fraud, independent of the alleged misrepresentations, and any act in furtherance of the sale of stock constituted fraudulent conduct.

2. The Public Offering Caused Detrimental Effects Within the United States: The Objective Territorial Principle.

The objective territorial principle recognizes the State's authority to regulate conduct outside its territory which has effects within it. This principle is expressed in the RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW of the United States, §18:

> "A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either
>
> (a) the conduct and its effects are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or

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* Paragraph 15 of the complaint alleges that Andersen should have withheld its certification of IOS' financial statements

(b)(i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems."

The rule of international law embodied in §18 has been applied in the prosecution of many criminal offenses. It was followed by the Permanent Court of International Justice in the case of the S.S. Lotus,* where acts or omissions done within one state produced unintended effects in another. Since Lotus, the objective territorial principle has been routinely followed by the courts which have recognized that the increasingly complex and burgeoning economy to which regulatory legislation is now directed is typified by a large number of transactions which affect interests located in more than one jurisdiction. The Supreme Court of the United States recognized the principle in the case of Steele v. Bulova Watch Co., supra. In applying the Lanham Act to conduct occurring in Mexico, the Court noted that acts which "radiate unlawful consequences" are not immune from regula-

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* Case of the S. S. "Lotus" (1927), P.C.I.J., Ser. A No. 10 at 23.

tion "merely because they were initiated or consummated outside the territorial limits of the United States". The extraterritorial application of our laws is a necessary corollary for their domestic enforcement which could otherwise be evaded "in a privileged santuary beyond our borders." (344 U.S. at 287, 288)

The principle was similarly employed in United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945)* where the Court applied the Sherman Act to conduct on foreign soil by foreign defendants where it had materially noxious consequences within the United States. Judge Learned Hand stated:

> "On the other hand, it is well settled law ... that any state may impose liabilities even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends and these liabilities other states will ordinarily recognize." 148 F.2d at 443.

In United States v. Watchmakers of Switzerland Information Center, Inc., 1963 CCH Trade Cases ¶70,600, at 457 (S.D.N.Y. 1962), the Court stated:

> "in the absence of direct foreign governmental action compelling the defendants' activities, a United States

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* The Alcoa case is but one of many cases overruling the narrow interpretation of Sherman Act jurisdiction espoused by the Court in American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909) and followed for some years thereafter. See also Continental Ore Co. v. Union Carbide & Carbon Corp. 370 U.S. 690 (1962)

> court may exercise its jurisdiction as to acts and contracts abroad, if ... such acts and contracts have a substantial and material effect upon our foreign and domestic commerce."

In Schoenbaum v. Firstbrook, supra, the Court impliedly based jurisdiction on the objective territorial principle, holding that the Securities Exchange Act of 1934* had extraterritorial application in the case of transactions which are detrimental to the interests of American investors. In Schoenbaum, the only U.S. contact was the registration of the stock in question upon a domestic exchange. However, the court held that the fraud, which took place totally outside the United States, had an effect within the country which warranted the assertion of jurisdiction, i.e., the "impairment of the value of American investment." Thus, transactions which have an impact upon the American securities markets are a proper target of the securities laws under the objective territorial principle as applied in Schoenbaum. Schoenbaum does not, as defendants suggest, purport to set forth "the exclusive circumstances in which extraterritorial application of the Act is proper" Travis v. Anthes Imperial Ltd., 473 F.2d at 523 n.14 (8th Cir. 1973). See also Leasco v. Maxwell,

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* The SEC also extended "the protective provisions of the Exchange Act to foreign corporations and their foreign shareholders" stating, "it has been long settled that 'any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends'". Arthur Lipper Corp., supra, p. 80,439.

supra; Roth v. Fund of Funds, 405 F.2d 421 (2d Cir. 1968), cert. denied, 394 U.S. 975 (1969); Wandschneider v. Industrial Incomes, Inc., 1971-72 CCH Fed. Sec. L. Rep. ¶93,422 (S.D.N.Y. 1972); SEC v. Gulf Intercontinental Finance Corp., 223 F.Supp. 987 (S.D. Fla. 1963).

In the instant case the debacle of the IOS Public Offering produced serious deleterious consequences within the United States. The fraud alleged herein had two significant domestic effects:

1. The reputation of American securities markets was adversely affected, as was the confidence of foreign investors, inhibiting sales abroad of registered companies and increasing the difficulty of raising foreign capital.

2. There was an increased redemption of the shares of mutual funds managed by IOS, requiring corresponding sales by the funds of large blocks of stock, primarily of United States securities traded on American securities markets.

a. The Integrity of American Markets Was Tainted

When foreign purchasers deal with American defendants, the integrity of the American securities markets is necessarily implicated in the transactions. The United States' market

image was tarnished by the IOS offering, resulting in loss of investor confidence in that market and, in particular, in American underwriters. IOS was viewed by most European investors as an American entity. In addition, American underwriters, lawyers and accountants were involved in the offering, and the prospectus prepared by them purported to meet American disclosure standards. The discovery that investors had been exploited and abused necessarily affected the general reputation of the United States securities markets and United States brokerage firms who are active in selling securities abroad.

The SEC in its Institutional Investor Study Report, Vol. 3,H. Doc. No. 64, 92nd Cong., 1st Sess. 922 (1971) found that the poor quality of disclosures made to foreign investors in offshore funds by certain issuers and the conflicts of interest which permeate these funds caused foreign governments to restrict sales of registered as well as unregistered funds, and caused investor confidence in United States-based and offshore mutual funds to erode. 3 Institutional Investor Study Report, at 949-950. The Report stated with respect to foreign investors:

"The inflow of foreign capital to the U.S., in addition to being a function of U.S. market performance, is also a function of the flow of cash from foreign financial institutions that actually make the investments. The largest offshore fund complex, Investors Overseas Services (IOS), has suffered a series of setbacks that have reportedly frightened off many small and medium sized investors; it is precisely these investors who made their previous investments in offshore funds because they had been actively solicited by a direct sales force... [T]he small and medium sized savers who were contacted by direct sales forces represented a new, net addition to the international flow of capital. To the extent that the "IOS debacle" has shaken their confidence and diminished the flow, the contribution of the offshore fund industry to the U.S. balance of payments and capital market has also suffered." (Page 943)

Professor Morris Mendelson confirms the loss of investor confidence stating:

"The aftermath of the Public Offering was a debacle of monumental proportions which resulted in a deterioration of investor confidence in American underwriters at home, and particularly, abroad. It occurred at a time when our economy was in the throes of tightening capital markets. Many United States corporations needing funds for expansion looked for European sources of funds. The adverse publicity attendant upon its subsequent failure of the IOS stock so offered was one factor which increased the difficulty of United States corporations seeking to raise capital abroad.

In order to maintain a healthy securities market, it is important that investors have trust and confidence in the information they receive and the parties associated with its dissemination. To the extent the investors' confidence and trust is impaired, investors retreat from that market and seek alternative investment media. Withdrawal of funds from a security market inevitably depresses the market.

The false and misleading prospectus issued in connection with the Public Offering impaired investors' confidence and trust and contributed to a steep decline in the purchase of United States securities by foreigners. In 1969, when the impact of the IOS Public Offering was greatest, there was a net disinvestment by foreigners in American stocks of $290,000,000. (Source: Federal Reserve Bulletin). This substantial swing of funds from our market contributed to the depression of stock prices that was being experienced in the American market at the time. Both the U.S. balance of payments and American investors holding United States securities were adversely affected. American companies with access to the international market had to pay more for their money as securities prices declined and confidence in the dollar waned." (71-A-2-3)

Coleman of Drexel also confirmed the deleterious effect upon American underwriters, acknowledging that the IOS offering had adversely affected his firm. He testified:

"Q. What were the detrimental effects?

A. Well, the detrimental effects were that when IOS got in serious difficulties and it was disclosed that the application proceeds of the issue had been used for purposes other than as stated in the prospectus, that I would think that Drexel's foreign securities business diminished.

Q. In fact, did Drexel's foreign securities business diminish?

A. Yes."

(18b-1PA)

b. Increased Redemptions Caused Adverse Effects Within the United States

An offshore mutual fund conglomerate such as IOS has substantial involvement with the United States securities markets by virtue of massive trading in United States securities and promotion, management and advisory functions carried out by United States citizens. Since funds such as those managed by IOS do not sell to large numbers of American citizens, their most immediate domestic impact is through investments made in United States securities. Their tremendous assets invested in the domestic markets give such funds a significant potential to create market instability. Large, quickly completed programs of liquidation, thus, directly affects the price structure of the security sold.

"The total net assets of the mutual funds managed by IOS were $1.8 billion at August 31, 1969, of which approximately $1.2 billion or about two-thirds were invested in equity securities of United States corporations."*

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* Foreign Bank Secrecy & Bank Records, Hearings before the Committee on Banking and Currency, House of Representatives, 91st Congress, December 4, 10, 1969, March 2 and 9, 1970, p. 195.

In 1967, subsidiaries of defendant IOS held over twenty percent of the shares of several United States mutual funds and significant percentages of many others.* The effect of the Public Offering on one mutual fund under IOS management, FOF, is described by Professor Mendelson as follows:

> "IOS' principal business activity at the time of the Public Offering was the sale and management of mutual funds. Among the funds sold and managed by IOS was Fund of Funds, Limited. Subsequent failure of this Public Offering caused loss of investor confidence in IOS as a competent manager of money. Many investors owning shares of Fund of Funds redeemed their holdings. At the time of the Public Offering, Fund of Funds had net assets of approximately $675,000,000. More than two-thirds of Fund of Funds' assets were invested in United States securities.** I have been advised by Sidney B. Silverman, Esq., attorney for the plaintiff, that Fund of Funds' present net asset value is $110,000,000.
>
> When a shareholder redeems his securities, he is paid the then net asset value of the fund's shares in cash. In order to have the cash to meet anticipated redemptions, a fund replenishes cash by liquidating part of its portfolio. The decline in Fund of Funds' net assets resulted in large part from redemptions. Fund of Funds must have sold a substantial part of its portfolio to raise the cash necessary to pay its redeeming shareholders. Wholesale sales of Fund of Funds' portfolio securities, consisting mainly of United States securities, would have a triple impact upon the American securities market. First, the sale of large blocks of stock, even in a turn-around situation (where the seller reinvests the proceeds in other United States securities) would have a depressing effect on the price of the stock sold. Second, the

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* See New York Times, May 25, 1967, at 75, col. 7

** Thus, foreign purchasers of IOS securities indirectly invest in the American securities markets. This factor significantly distinguishes such purchasers from the German and Japanese businessmen who meet in New York for convenience hypothesized in the Leasco case. (footnote added)

net withdrawal of funds from the U.S. market as a whole also had an adverse effect on American market prices in general. Third, it is likely that in numerous instances, specific securities in Fund of Funds' portfolio had to be disposed of under forced sale circumstances which would disrupt orderly markets." (71A-4-71A-5)

As defendant Andersen points out, the SEC, in its Investors' Study Report, concluded that IOS redemptions probably did not have a significant, direct effect on general U.S. market stability because of that market's size and breadth. However, as defendant Andersen does not reveal, the Report continued by noting the effect upon individual securities, stating:

"On the other hand, the effect on a given security, particularly if narrowly held or with only a small float, could be noticeable." Special Study supra, vol 3, p. 947

Such a result was consistent with the large, concentrated holdings of IOS and IOS-affiliated companies in certain domestic companies, as reflected in the report of the staff of the Committee on Banking and Currency:

"Our analysis of the information in the list* indicated that IOS and its affiliates held stock, bond, or note interests in a total of about 522 companies (domestic and foreign) at September 25, 1969, and their combined holdings represented 4 percent or more of the outstanding issues of such holdings in about 62 of the 522 companies. About 464 of the 522 companies were United States companies and the IOS and affiliated company combined holdings represented 4 percent or more of

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* A listing of IOS and IOS-affiliated Company investments at September 25, 1969, furnished by Securities and Exchange Commission personnel. Bank Secrecy Hearings, supra p. 195

> the outstanding issues of such holdings in about 50 of the 464 United States companies."*

Thus, the court below properly found that "some credence must be given to the general proposition that a collapse of a public offering by a company whose subsidiaries trade and had massive amounts of American securities would have a negative impact on the securities markets." (269 A)

Moreover, the loss of investor confidence and the redemptions resulting in the sale of domestic securities, as described above, had an impact not only upon the integrity and stability of the United States securities markets, but also upon United States monetary policy, since foreign purchases of American securities have a significant effect upon the balance of payments of the United States. In the early 1960's "[t]he magnitude and persistence" of United States balance of payments deficits was "of increasing concern to both the public and private sectors of our country."**

The Task Force on Promoting Increased Foreign Investment was appointed by President Kennedy as part of

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* Bank Secrecy Hearings, supra p. 195

** U.S. President's Task Force on promoting foreign investment in United States corporate securities and increased foreign financing for United States corporations operating abroad. Report to the President of the United States (1964).

his administration's policy to reduce the United States' balance of payments deficit. The Task Force stated in its report that this deficit, if continued, "would endanger our international financial position." (168 PA) One of the aims of the Task Force was to determine ways to improve the United States balance of payments by increasing foreign investment in United States' securities. One of its suggestions, the revision of United States taxation of foreign investors in United States' securities, was implemented by the passage of the Foreign Investors Tax Act of 1966 (FITA). Following the passage of FITA, foreign investment in the United States securities markets accelerated and this stimulation of portfolio activity had a significant effect on its balance of payments position. In 1968, investments by foreigners in American stocks soared to 2.3 billion from $757 million in 1967. IOS "single-handedly accounted for a flow of $430 million to the U.S." in 1968. (168 PA)

However, as Professor Mendelson affirms, the collapse of IOS soured foreign investors and discouraged their investment in American securities. It, thus, affected this country's balance of payments position. Since, as pointed out by the Task Force, the attraction of increased

foreign investment is one of the most effective methods of improving this nation's poor balance of payments position, the impairment of confidence in our securities markets directly contravened American international economic policy. The interest of this country in protecting the integrity of the securities markets in order to promote the flow of capital to the United States justifies the extension of the American securities laws to protect foreigners injured by Americans and their associates who violated such laws.

Professor Mendelson's views are shared by the SEC. In its Institutional Investor Study Report, the Commission noted the loss of confidence by foreign investors and concluded that:

> "to the extent foreign sales of U.S. funds have been adversely affected, the U.S. balance of payments and capital market may have been denied a positive cash flow .... Furthermore, to the extent that the recent, well-publicized difficulties of offshore funds have engendered net redemptions by shareholders and have led to the net sale of U.S. securities by the funds, the U.S. is detrimentally affected by an outflow of foreign capital in the balance of payments and by selling pressure on individual securities." (Id. at 952).

Although the detrimental effects of the IOS Public Offering were different from those in both Schoenbaum and Leasco, plaintiff believes that these effects amply warrant the application of the Exchange Act to the transaction. In both Schoenbaum and Leasco, the fraudulent transactions affected American corporations traded on an American exchange, with effects ultimately reflected in lower prices on that exchange. In the instant case, however, as shown above, the fraudulent transaction had direct effects upon American securities markets, impugning their integrity and resulting in a diminished flow of foreign capital and "selling pressure on domestic securities." Thus, it would appear more than reasonable to assume that Congress intended that American markets be protected from such adverse effects of a fraud, particularly where American entities and contacts play such an important role in the transaction.

3. The Principal Defendants were Americans; The Foreign Defendants were Aiders and Abettors of Americans: The Nationality Principle

The nationality of the defendants, in and of itself, may provide the basis for extraterritorial application of legislation since a country has jurisdiction over the conduct of its nationals, even though such conduct occurs without its territory. §30 of RESTATEMENT (SECOND) UNITED STATES FOREIGN RELATIONS LAW, provides:

"§30. Jurisdiction to Prescribe with Respect to Nationals

(1) A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct of a national of the state wherever the conduct occurs; or

(b) as to the status of a national or as to an interest of a national, wherever the thing or other subject-matter to which the interest relates is located."

The nationality principle has been universally adopted by members of the international community and "under existing international practice, a State is assumed to have practically unlimited legal control over its nationals."*

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* Research in International Law: Jurisdiction with Respect to Crime, 29 Am. J. Int'l. L., 435, 519,520.

The United States has accepted the principle that the privileges and protection of American citizenship carry with them a duty to conform to certain standards of conduct. In particular, our government has asserted jurisdiction to punish nationals for crimes committed abroad. The courts have likewise recognized this principle in determining application of the securities laws. In SEC v. Gulf Intercontinental Finance Corp., 223 F.Supp. 987 (S.D. Fla. 1963), the Court looked through "the transparent fabric" of the challenged transaction and concluded that the true issuers of the securities involved were Americans who used a Canadian corporation as "a conduit for the securities to be issued by the Florida defendants." at 995. Although the Court did not specifically base its finding of subject matter jurisdiction upon the nationality of the defendants, the facts of that case indicate that it was a determinative factor in the decision. In SEC v. United Financial Group Inc., 474 F.2d 354 (9th Cir. 1973), the nationality of the defendant, a Delaware corporation, was deemed a critical factor which, coupled with the fact that some Americans were allegedly defrauded and the mails and other facilities of interstate commerce of the United States were used, provided "sufficient evidence for subject matter jurisdiction" under the American securities laws. See also Matter of Waddell & Reed, Inc.,

[1972-73] CCH Fed. Sec. L. Rep. ¶79,049 (Securities Exchange Act Rel. No. 9790, 1972).

Although the nationality of the defendants, alone, may, under the nationality principle, provide sufficient basis for the assertion of subject matter jurisdiction, the Courts have not as yet sustained jurisdiction solely* on this ground. However, the cases reveal that it is accorded great weight in favor of the assertion of jurisdiction in any dispute relating thereto.

Defendants Drexel and Smith, Barney are United States corporations, maintaining their principal executive offices in the United States. Both are registered with the Securities and Exchange Commission as broker-dealers and are members of the National Association of Securities Dealers, Inc. These defendants constituted two of the six principal underwriters of the primary offering and their names appeared on the cover of the main prospectus. Drexel assumed the lead position and underwrote the largest number of shares (478,000). Twenty-five additional American firms participated in this underwriting. Shares underwritten by Drexel and Smith, Barney totalled over $8,000,000, the entire American underwriting over $15,000,000.** Defendant Arthur Andersen, the

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* In Finch v. Marathon Securities Corp., 316 F. Supp. 1345 (S.D.N.Y. 1970), the court's finding that six of the defendant fund's eight directors were Americans partially bridged the jurisdictional gap.

** (175 A).

accounting firm which played such an important role in the preparation of the prospectus, is also an American firm.

Although IOS was a foreign based corporation, its image was that of an American company.* Its close contact with the United States including its securities caused IOS to be viewed abroad as an American entity. The United States has consistently treated as domestic corporations certain companies incorporated in foreign countries, but having substantial financial links with the United States and American citizens in important management positions.** Thus, the exploitation of investors by IOS in conjunction with American underwriters and accountants provides, under the nationality principle, a sound basis for the assertion of subject matter jurisdiction.

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* A State has competence to exercise jurisdiction over juristic persons, including corporations, having said State's national character. Research in International Law; Jurisdiction with Respect to Crime, 29 Am. J. Int'l. L. 435, 538.

** See Foreign Asset Control Regulations.

2. Congressional Intent Does Not Limit Application of the Principles of International Law to the Facts of this Case

The court in Leasco indicated that it would be bound to follow "Congressional direction" in transnational disputes. However, there is no express statutory language which defines the international reach of the securities laws, and the legislative history of the statutes gives little hint as to precisely what Congress intended. Accordingly, the courts are left to fathom the Cogressional purpose.

The courts have evolved a broad rule in anti-trust cases, sanctioning the extraterritorial application of American law where significant acts occurred within the United States or where foreign conduct caused adverse consequences within it.* The approach employed in those cases involving interstate commerce may prove somewhat helpful in judging cases involving violations of the Securities Exchange Act which defines "interstate commerce" to include "trade or commerce in securities, or any transportation or

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* United States v. Aluminum Co. of America, supra (Sherman Act); United States v. Watchmakers of Switzerland Information Center, Inc. (Sherman Act).

communication relating thereto among several states ..., or between any foreign country and any state.* The specific language of the Securities Exchange Act,** as well as its legislative history,*** indicate that Congress intended the

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* The commerce power, U.S. Const. Art. I, §8, has generally been construed to extend to all commerce, including entirely foreign, which has an effect upon commerce between the United States and other countries. See Vanity Fair Mills Inc. v. Eaton, 234 F.2d 633 (2d Cir.) cert. denied 352 U.S. 871 (1956). Securities are included in the definition of commerce. 15 USC §77(b)(7) (1964).

** The preamble to the Securities Exchange Act expresses the Congressional intent that the Act should "provide for the regulation of securities exchange and of over-the-counter markets operating in interstate and foreign commerce.... 48 Stat. 881 (1934) (emphasis supplied). Similarly, the preamble to the Securities Act expressly states that that Act is intended

> "To provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails and to prevent frauds in the sale thereof, and for other purposes." 48 Stat. 74 (1933) (emphasis supplied).

*** The Senate Committee considering the Securities Exchange Act noted:

> "Foreign money had also been attracted to the call market, and was subjected to heavy withdrawal which contributed to the panic and the hoarding of gold associated with the dislocation of the national currency system."

S. Rep. No. 792, 73d Cong., 2d Sess. 304 (1934) (emphasis supplied).

securities laws to encompass foreign transactions having an impact in this country. However, in the absence of clear statutory direction, the rules of international law would appear to provide the most approximate guidance. The Court in Schoenbaum and Leasco have followed this route, keeping in mind the broad outlines of Congressional intent, i.e., the promotion of American securities markets of integrity and reliability.

In the instance case, plaintiff has shown circumstances sufficient to warrant the conclusion that Congress would have intended the extraterritorial application of the securities laws herein. Acts constituting an essential link in the course of conduct resulting in the loss complained of took place in this country. Additionally, a significant adverse effect upon domestic securities markets resulted from the defendants' foreign conduct. Plaintiff submits that it would not be inappropriate to extend the protection of American law to foreign investors who participate in American markets through the medium of overseas funds, particularly where such investors have been damaged by Americans, professionals in the securities markets, whose fraudulent scheme was carried out in part within the United States.

POINT II

SECTION 30(b) DOES NOT EXEMPT DEFENDANTS FROM THE OPERATION OF THE ANTI-FRAUD PROVISIONS OF THE AMERICAN SECURITIES LAWS

The requirements for exemption under Section 30(b) of the Securities Exchange Act of 1934 have not been met. That section provides:

> "The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States. unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter."

Legislative history relating to §30(b) indicates that Congress intended that section to prevent the evasion of the Exchange Act and SEC regulatory rules.* The courts, in construing §30(b), have not interpreted "jurisdiction" in geographic terms. In SEC v. United Financial Group, Inc., supra, the court cited Schoenbaum v. Firstbrook, supra, in support of its holding that "jurisdiction" as employed in §30(b) is not defined as "territorial limits." The court stated:

> "Since the Commission has not exercised its rule-making power under this section, the argument runs, the appellants' activities are exempt from regulation. The difficulty

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* Hearings on S. Res. 84, 56 and 97 Before the Senate Comm. on Banking and Currency, 73d Cong., 2d Sess. pt. 15, at 6436 (1934).

> with such a position is that it overlooks the key phrase of 'without the jurisdiction of the United States.' (Emphasis added). Appellants' argument has apparently construed 'jurisdiction' to mean 'territorial limits'. It is clear from prior decisions, and we so hold, that it has no such meaning." 474 F.2d at 357-58.

The language of §30(b), which contains the phrase "insofar as", envisions a divisibility of the securities business involved into transactions within and without the jurisdiction of the United States. It is aimed not only at the general nature of a person's business, but at the nature of the challenged transaction. Thus, if the transaction is within the jurisdiction of the United States, §30(b) does not apply.

The authorities interpreting §30(b) have held that the exemption provided by it is lost if significant acts are performed here. Such acts have included the use of an American securities exchange, Roth v. Fund of Funds, supra, the origination of a fraudulent plan involving a false prospectus, Wandschneider v. Industrial Incomes, Inc. of North America, supra, and the tender of directors' resignations in connection with the transfer of corporate control, Ferraioli v. Cantor, 259 F. Supp. 842 (S.D.N.Y. 1966). It is clear that unless there is a positive showing "that all the essentials of the transactions in question occurred

outside of the United States," the exemption does not attach. IOS, Ltd. (S.A.), [1971-72] CCH Fed. Sec. L. Rep. ¶78,637 (S.E.C., March 14, 1972); cf. Fontaine and IOS v. SEC, 259 F. Supp. 880 (D.P.R. 1966).

The prerequisite showing cannot be made herein. As plaintiff has demonstrated supra, significant acts essential to and in furtherance of the alleged violation were committed here. Accordingly, the provisions of §30(b) do not apply.

In addition, the section is inapplicable to the American defendants on a further ground. That section was enacted in order to exempt foreign brokers, dealers and banks from "complying with the burdensome reporting requirement of the Act." It is clear that the purpose of the section was not to exempt Americans, subject to the penalties of the Act, but was to relieve "the Commission of the impossible task of enforcing American securities laws upon persons whom it could not subject to the sanctions of the Act for actions upon which it could not bring its investigatory powers to bear." Schoenbaum v. Firstbrook, supra, at 207-8. Since defendants Drexel and Smith, Barney are regularly supervised by the SEC, no purpose is served in exempting them.

As indicated supra, the SEC made clear its position that the American securities laws applied to the IOS

Public Offering. It stated in a letter to Murphy:

> "As a general rule, a registered broker-dealer may participate in the underwriting outside of the United States of a security not registered under the Securities Act of 1933 of a foreign issuer and which is to be offered and sold to foreign nationals only (Securities Act Release No. 4708, July 9, 1964; Investment Company Act Release No. 5618, February 25, 1969). However, though Securities Act registration of such an offering is not required, the anti-fraud provisions of the Securities Act and the Securities Exchange Act of 1934 would, in general, be applicable to the activities of a registered broker-dealer participating in such an underwriting. (Emphasis Added). (73 PA).

In addition, by letter dated August 21, 1969, it advised that registration was required in connection with sales to American nationals:

> "We would like to point out, however, that any sale of I.O.S., Ltd.'s stock to its employees who are nationals of the United States but residents abroad would be subject to the registration requirements of the Securities Act of 1933." (213 A-3).

Accordingly, it is clear that the exemption of §30(b) does not apply to the American underwriters.

Defendant Andersen cannot obtain the exemption. It is a firm of accountants and thus is not, under any circumstances, a person who "transacts a business in securities" anywhere.

The foreign defendants cannot claim an exemption since §30(b) does not exempt them with respect to all transactions. As stated in Schoenbaum:

> "If §30(b) has been meant to exempt every transaction by any person outside of the United States, it would have been drafted to state that the Act does not apply to any transaction in any security outside the jurisdiction of the United States, ..." 405 F.2d at 208.

It clearly provides no exemption for this transaction, which was effected in part within the United States. Defendants Crang and IOB performed essential acts here - IOB sold stock and Crang purchased stock from Americans. Additionally, as plaintiff has demonstrated in his brief relating to personal jurisdiction over Crang, that defendant was registered with the SEC and carried on business in the United States. Defendant Guinness Mahon is also represented in the United States, with an office in New York City. Defendant Hill Samuel likewise has offices in this city. Defendants IOS, Guinness Mahon and Banque Rothschild have engaged in other securities transactions within the United States.* The remaining defendants were joint participants in a public offering having significant contact in the United States. They employed the instrumentalities of interstate commerce, the mails, and the services of American accountants and lawyers. They cannot claim an exemption as a foreign business operating wholly without the United States.

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* See, e.g., Bank Secrecy Hearings, supra, at 299.

1. Defendants Cannot Claim an Exemption Under the Securities Act

Plaintiff has alleged that defendants violated §§12(2) and 17 of the Securities Act of 1933,* as well as provisions of the Securities Exchange Act of 1934. Had Congress intended to extend the exemption contained in §30(b) to the anti-fraud provisions of the Securities Act, it would have amended that Act accordingly. Defendants ask this Court to do what Congress specifically did not do.

2. Andersen and the Foreign Defendants Are Liable as Aiders and Abettors

Assuming, arguendo, that the foreign defendants may claim a 30(b) exemption, they are, nevertheless, liable as aiders and abettors of the American firms which are not exempt. All were participants in the fraudulent transaction, and all were knowledgeable associates in the over-all scheme. The actions of the foreign broker-dealers aided and augmented those of their American partners, and they cannot be divorced therefrom.

Liability as an aider and abettor derives from the fraud provisions of the American securities laws, and the federal aider and abettor statute. (18 USC §2). The aider

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* 15 U.S.C. §§ 771 and q.

and abettor concept is borrowed from criminal law and has tort law antecedents. It has been applied in private actions under the American securities laws.

A person may be held liable as an aider and abettor, although his liability as a principal is precluded by statute. United States v. Weisscredit Banca Commerciale E. D'Investimenti, supra. The degree of aid required to give rise to liability is not extensive, and may consist of mere silence or inaction. Brennan v. Midwestern United Life Insurance Co., 259 F. Supp. 673 (N.D. Ind. 1966). In Anderson v. Francis I. duPont & Co., 291 F. Supp. 705 (D. Minn. 1968), the defendants were charged with allowing an unlicensed commodity-dealer to use their offices in the course of his fraudulent promotion. This, it was contended, lent the aiders "established reputations" to the unlawful scheme. The Court held that a good cause of action had been stated.

Aiding and abetting requires that the defendant have some knowledge of the fraudulent act or scheme he is aiding. However, such knowledge need only be some general awareness that his role is part of a complex activity and that the over-all conduct is in some was improper. A. Bromberg, Securities Law; Fraud - SEC Rule 10(b)(5), §8.5 (582) p. 208.45 (1970 Supp.). The degree of knowledge

necessary can be shown by circumstantial evidence. Securities and Exchange Commission v. Scott Taylor & Co., 183 F. Supp. 904 (S.D.N.Y. 1959). Plaintiff submits that such knowledge was present in this case.

The aiding and abetting theory can be employed to establish defendants' complete joint liability. SEC v. National Bankers Life Insurance Co., 324 F. Supp. 189 (N.D. Tex. 1971). The various activities of each defendant were part of an integrated plan, and this combined activity renders them jointly liable. If, as plaintiff alleges, defendants Drexel and Smith, Barney are liable, the foreign underwriters, by virtue of their participation in the joint venture with them, are likewise. Their liability as aiders and abettors is equal to that of their associate perpetrators. Petitt v. American Stock Exchange, 217 F. Supp. 21 (S.D.N.Y. 1963).

The law discussed above with respect to the foreign underwriters applies with greater force to the defendant Andersen who can claim no exemption under §30(b). The financial statements certified by it "were intended for public information and to induce the public to buy securities." Drake v. Thor Power Tool Co.,282 F. Supp. 94 N.D. Ill. 1967). Thus, Andersen's participation was a necessary element in the alleged fraud and it is, accordingly, jointly liable therefor.

POINT III

THE DISTRICT COURT HAS JURISDICTION OVER CLASS MEMBERS WHO ARE NON-RESIDENT ALIENS.

Defendants contend that if applicability of the federal securities laws to the challenged transaction is found by this Court, subject matter jurisdiction should be limited to the plaintiff and the other resident Americans who bought in the United States. Defendants base their contention upon cases which deal primarily with the quantum of damages, holding that in diversity cases each class member must meet the requisite jurisdictional amount.* However, in class actions where jurisdiction is premised upon a violation of federal law, a finding of subject matter jurisdiction will negate the jurisdictional amount requirement as to all class members.** Accordingly, the question presented herein is whether a finding of subject matter jurisdiction would encompass all class members. Plaintiff submits that it would.

While it is now clear "that in a spurious class

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* Snyder v. Harris, 394 U.S. 332 (1969); Zahn v. International Paper Co.,469 F.2d 1033 (2d Cir. 1972), affirmed 414 U.S. 291 (1973).

** As the court stated in Snyder, at 326: "the jurisdictional amount requirement applies almost exclusively to controversies based upon diversity of citizenship. A large part of these matters involving federal questions can be brought, by way of class actions and otherwise, without regard to the amount in controversy." The jurisdictional amount is not an issue here.

action one plaintiff may not ride in on another's coattails,"* such a result would not obtain in this action since, contrary to defendants' contentions, foreign plaintiffs would have an independent cause of action. Plaintiff has shown, supra, that subject matter jurisdiction in this case may be based upon significant conduct in the United States, harmful effects within the United States and the American "identity" of the defendants. The United States, thus, has a substantial interest in the resolution of the dispute. Accordingly, the District Court has the power to exercise jurisdiction over the claims of all who were injured by the challenged transaction.**

However, even assuming, arguendo, that subject matter jurisdiction were predicated solely upon sales to Americans in the United States, such a result would not preclude the suit by foreign purchasers. In Kohn v. American Metal Climax, Inc., 458 F.2d 255 (3d Cir. 1972), a Zambian corporation about to be nationalized negotiated to sell its externalized assets to its largest shareholder, an American corporation, and proxy materials disclosing the agreement were alleged to be misleading. The appellate court confirmed

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* Zahn v. International Paper Co., supra, 469 F.2d at 1035.

** No special provisions bar foreigners from the right to invoke the federal securities laws. "[T]he Securities Act confers jurisdiction of the suit upon the District Court irrespective of the amount in controversy or the citizenship of the parties." Deckert v. Independence Shares Corp., 311 U.S. 282, 289 (1940).

the action of the lower court ordering an "exchange offer remedy" applicable to all class members, including Zambian citizens and residents who had purchased their shares of a Zambian corporation in Zambia and who had received the disputed proxy material in that country.

Application of the Exchange Act to foreign class members is far more appropriate herein than in Kohn. In the instant case, many foreign residents, even though buying abroad, had a direct connection with the United States securities market since they purchased their shares from American underwriters registered with the SEC and from J. H. Crang, also a registered broker-dealer. These sellers were on notice that the SEC deemed federal securities laws applicable.*

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* Moreover, even assuming that the establishment of subject matter jurisdiction herein may result in extending the protection of the anti-fraud provisions to purchases of Euro-dollar offerings, the consequences would not be inimical. The SEC has freed such offerings from the burden of complying with the registration requirements of the Securities Act of 1933 and the strict liability which flows from even an innocent mistatement contained in a registration statement. (See, for example, §12(2) of that Act). The SEC has not, nor we submit should the Courts, extended a license to Americans to engage in fraud in connection with sales of securities to foreign nationals. Denial of protection based upon nationality could raise if not a due process issue, at the least, a basic question of fairness.

Additionally, the rationale of Snyder v. Harris, supra, does not apply with equal strength to the instant action as it does to Zahn. While it is self-evident that satisfaction of the jurisdictional amount by one class member cannot affect the failure of another to do so, sales to American residents in America may bring the entire transaction within the ambit of the federal securities laws so as to encompass all class members who choose to be included in the class. In Securities and Exchange Commission v. United Financial Group, Inc., supra, at 356-57, the court found subject matter jurisdiction, based in large part upon "offers and sales of stock to American citizens." The court stated:

> "Although there was a showing of only a few instances involving American investors relative to the total sales volume, jurisdiction may not be resolved by a mere tallying of domiciles of shareholders. The relative number of American citizen shareholders vis-a-vis alien shareholders is not determinative of whether United States courts may assert jurisdiction. In this case, focus should be upon appellants' activities within the United States and the impact of those activities upon American investors. Here, there was a showing of very substantial activities by appellants within the United States and a showing that, as a result of those activities, at least three American investors now hold nearly $10,000 worth of stock for which there appears to be no market and which appellants have declined to redeem although requested to do so. Since the securities laws have always been construed

> very broadly to promote the remedial purposes behind them, we find unpersuasive the argument that jurisdiction should be declined because only a very few instances of sales to American citizens have been shown, especially given the practical difficulties present in this case. 'That the jurisdictional hook need not be large to fish for securities law violations is well established.' Lawrence v. SEC, 398 F.2d 276, 278 (1st Cir. 1968)." (footnotes omitted)

Although the United Financial Group case was not a class action, the decision, nevertheless, predicated jurisdiction by the SEC over activities of off-shore mutual funds in part upon sales to a few American investors. Application of that decision to the present case would bring the Public Offering within the District Court's jurisdiction and with it, foreign purchasers.

The court in Securities and Exchange Commission v. Gulf Intercontinental Finance Corp., Ltd., supra, recognized that distinctions based on citizenship are without merit. It stated:

> "there is nothing within the Acts in question [the Securities Act and the Securities Exchange Act] which would appear to limit the protection offered by Section 17(a) [of the Securities Act] and Rule 10b-5 to residents of the United States. It would appear that where the scheme is one which necessarily must be accomplished in part by use of the mails or interstate facilities within the limits of our federal jurisdiction that even through the offer were made entirely outside the nation that the remedial protection of these sections may be invoked... The courts of this nation have consistently repeated that the acts shall be given a liberal construction to accomplish their purpose." at 995.

See also, Wandschneider v. Industrial Incomes Inc. of North America, supra.

Thus, it is clear that the District Court has the power and authority to extend the protection of the securities laws to foreign purchasers. Additionally, plaintiff contends, such action does not contravene Congressional intent. As discussed above, the interest of the United States in protecting the integrity of its securities markets justifies the extension of the Exchange Act's provisions to foreign investors defrauded by Americans through domestic conduct. Plaintiff submits that "if Congress had thought about the point", it would have agreed. No principle of international law or policy of diplomacy is offended by allowing foreign nationals to invoke our laws to recover their losses occasioned by activites which took place here. American courts may be the only forum in which all foreigners may obtain effective redress.* Although commercial fraud is a concept recognized

* The only foreign action commenced to date is a suit in Switzerland. Although defendants attempt to inflate the importance and effectiveness of this proceeding, it is unlikely to produce the monetary restitution due class members. The American underwriters and Crang are not involved and collection from the defendants named therein appears difficult. The Swiss attorney representing certain Swiss plaintiffs in that action, has been in correspondence with plaintiff Bersch's attorneys and made a visit to that firm's offices in New York to discuss the instant suit. He detailed the difficulty of recovering in Switzerland and requested that his clients be intervened herein. He was advised that since his clients are presently class members pursuant to the opinion of Judge Frankel, intervention would not be required. Accordingly, it would appear that this is the only forum in which foreign class members can obtain meaningful redress for the fraud by which they were victimized.

by most mercantile and industrial nations, procedural and jurisprudential differences exist which make it difficult, if not impossible, for the class of injured purchasers of IOS stock to sue. Plaintiff submits that the strength of all factors in the jurisdictional calculus herein justifies the transnational application of the American securities laws so as to encompass all persons who purchased IOS stock at the IOS Public Offering, whether they be foreigners or Americans.

Further, the inclusion of foreign purchasers in the class would not, as contended by defendant Andersen, frustrate the intent of Rule 23. That defendant relies upon documents which indicate that the statute of limitations has already run in Italy and no other foreign statute appears to threaten defendants with the possible exception of the French Civil Code. (125 A, 145 A). However, that jurisdiction can reach only Banque Rothschild, a defendant which has already agreed to settle.

Additionally, the individual notice approved by the Court fully comports with the requirements of due process as determined in Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974). Defendants confuse the due process requirements for the exercise of personal jurisdiction over a foreign defendant with notice to a potential plaintiff. In the former

case, the court is seeking by compulsion to subject the defendant to suit in a foreign forum. In the latter case, the court is notifying a possible plaintiff of his option to participate in a foreign suit. Numerous class actions have included foreign members and plaintiff submits, properly so.

Moreover, the issue of the adequacy of notice is a class action issue. As the court recognized in Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950), the validity of court action with respect to a class* and the appropriateness of the forum are separate and distinct from the issue of the adequacy of notice and representation.

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* Mullane was not a traditional class action, but involved suit by a special guardian on behalf of numerous trust beneficiaries.

POINT IV

CLASS ACTION ISSUES ARE NOT PROPERLY BEFORE THE COURT AT THIS TIME

Where an interlocutory appeal is taken, the appellate court will not go any further into the merits of the case than is necessary to decide the matter on appeal. Ex Parte National Enamel & Stamping Co., 201 U.S. 156 (1906); Magnetic Engineering & Mfg. Co. v. Dings Mfg. Co., 178 F.2d 866 (2d Cir. 1950); Drittel v. Friedman, 154 F. 2d 653 (2d Cir. 1946); Time, Inc. v. Ragano, 427 F.2d 219 (5th Cir. 1971); Virginia Automotive Ltd. v. Canair Corp., 393 F.2d 1256 (4th Cir. 1968); Barnwell Drilling Co. v. Sun Oil Co., 300 F.2d 298 (5th Cir. 1962); 9 Moore, Federal Practice, ¶110.25[i], 269-270 (2d Ed. 1973). Accordingly, since this court denied consolidation of the so-called "class action" appeal, plaintiff submits that defendants improperly raised the question of class action determination and that this appeal does not encompass that issue. Therefore, plaintiff does not deal herein with the propriety of class action status or questions bearing upon that determination.

CONCLUSION

Leasco's proverbial peripatetic German and Japanese businessmen lighting briefly in New York deserve a well earned rest after the relentless paces through which defendants' briefs have put them. They can be of little assistance in resolving the jurisdictional issues of this case, since their hypothetical activities are totally disparate from the conduct involved in this action. This case involves a chain of American events and actions including sales to Americans, of stock in a company controlled and largely owned by Americans, dissemination of prospectuses in the United States which were drafted in part in this country, American defendants using the means of Americans interstate and foreign commerce, conducting negotiations with American governmental agencies, and adverse effects in American securities markets.

The circumstances of this case empower the District Court to exercise subject matter jurisdiction and make it proper for it to do so. Accordingly, the judgment of the court below that it had subject matter jurisdiction should be affirmed.

Dated: New York, New York
February 24, 1975

Respectfully submitted,

Silverman & Harnes

SILVERMAN & HARNES
Attorneys for Plaintiff
75 Rockefeller Plaza
New York, New York 10019

STATE OF NEW YORK)
:
COUNTY OF NEW YORK)

MARTIN H. OLESH, being duly sworn, deposes and says: deponent is not a party to the action, is over 18 years of age and resides at 400 East 89th Street, New York, N.Y.

On February 24, 1975, deponent served the within PLAINTIFF-APPELLEE'S BRIEF upon the attorneys listed below, by delivering a true copy thereof to them personally at their respective addresses:

BREED, ABBOTT & MORGAN
One Chase Manhattan Plaza
New York, New York
Attorneys for Defendant-Appellant Arthur Andersen & Co.

WILLKIE FARR & GALLAGHER
One Chase Manhattan Plaza
New York, New York 10005
Attorneys for Defendant J. H. Crang & Co.

GOLD FARRELL & MARKS
595 Madison Avenue
New York, New York 10022
Attorneys for Defendant Bernard Cornfeld

WACHTELL LIPTON ROSEN & KATZ
299 Park Avenue
New York, New York
Attorneys for Defendant I.O.S., Ltd.

Martin H. Olesh
Martin H. Olesh

Sworn to before me this
24th day of February, 1975

Rosalie A. McGovern
Notary Public

ROSALIE A. McGOVERN
NOTARY PUBLIC, State of New York
No. 24-0706100
Qualified in Kings County
Certificate filed in New York County
Commission Expires March 30, 1975